BEVERAGE
ALCOHOL
SYSTEM
REVIEW

Strategy for TRANSFORMING Ontario's Beverage Alcohol System

A Report of the
Beverage Alcohol System
Review Panel

July, 2005

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BEVERAGE
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July, 2005

The Honourable Greg Sorbara
Minister of Finance

Dear Minister Sorbara:

It is my pleasure to submit the Report of the Beverage Alcohol System Review Panel, which you established in January 2005.

This report reflects the contributions of many different people in a variety of fields. I would especially like to recognize the hard work and creative thinking of my fellow Panel members – Gwen Boniface, Ann Dumyn and Suzanne Labarge.

The Panel received highly professional support from the Beverage Alcohol System Review Secretariat in the areas of research, policy and administration. I thank this group for their excellent work and singular dedication. A team of advisors and consultants provided the Panel with specialized expertise. Their assistance was invaluable. Finally, I want to acknowledge the wide-ranging and extremely helpful input we received from stakeholders and the public through face-to-face meetings, written submissions, our web site and other channels.

Though we have substantial experience in large public or private sector organizations, all of us on the Panel were struck by the complexity of the task we had undertaken. The beverage alcohol system consists of a dynamic retail sector operating within a rigid legal framework largely inherited from the end of the Prohibition era. A government monopoly and a handful of private interests dominate the market. The system is inflexible and there are many anomalies and inequities. If we could go back to the drawing board, no one would design an ideal system this way. Yet most industry stakeholders, we found, have learned to live with the system's inequities and constraints and make do.

The challenge you put to us was to determine if the beverage alcohol system is delivering the maximum benefits to the people of Ontario. It is not.

The overriding government objective remains as valid today as it was in 1927 – to reduce the potential harm from beverage alcohol. We accept without hesitation the view that alcohol is not just an ordinary consumer product. For generations, alcohol control has been a core function of government. It must and will remain so.

What we are discussing is a question not of ends, but of means. The Panel has examined how other jurisdictions answer this question. Our conclusion: in order to ensure the socially responsible sale and use of beverage alcohol, it is not necessary for government to own and operate retail and wholesale facilities itself. In the 21st century, government can protect the public interest just as well, if not better, through modern regulatory tools such as pricing policies and active enforcement.

But there is, however, more at stake here than social responsibility. Today, the government depends on the beverage alcohol system for significant revenues to help fund health care, education and other public priorities. We have found that the current system falls considerably short of generating the maximum return for taxpayers. Monopolies lock up economic value, and uncompetitive markets hold back innovation and value creation, leaving untapped revenue "on the table." We believe this revenue, which we estimate to be in excess of $200 million annually, should accrue to the people of Ontario.

This report outlines our recommended strategy for transforming Ontario's beverage alcohol system. It calls on the government to focus on its regulatory role and leave wholesale and retail operations to the private sector. We unanimously recommend that the government create a regulated, competitive market that would expand opportunities for producers, improve convenience and selection for consumers, extract the government from commercial risks and increase revenues for the public purse – all while protecting social responsibility.

In conjunction with our advisors, we have carefully weighed the financial implications of this strategy. We conservatively estimate that, following a transition period, this plan would produce at least $200 million more government revenue than the government currently receives from the beverage alcohol system. This additional revenue could be enough, for example, to build a new 300-bed hospital each year.

We realize that restructuring the system and getting the new system running smoothly would take time and present challenges – but we believe it's the right and fairer approach for Ontario to take.

Some may prefer to keep the system as it is and muddle through. This, however, would solidify the existing vested interests and make it much harder to effect change in the future.

After 78 years, action is long overdue. It is time to transform Ontario's beverage alcohol system. I close with what I believe are the real outcomes of our recommendations:

1. the consumer would get greater convenience and choice and would benefit from a competitive retail environment;
2. the government would remove itself from investment risk while increasing its annual revenues;
3. Ontario would continue to benefit from sound social responsibility practices; and
4. the existing commercial inequities would have been materially addressed.

J Lacey

John Lacey
Chair

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EXECUTIVE SUMMARY

The Ontario government established the Beverage Alcohol System Review Panel in early 2005. We were asked to determine if the beverage alcohol system is generating the maximum benefits for the people of Ontario. Our review was the first comprehensive look at the system since it took shape at the end of Prohibition in the late 1920s.

Despite our different backgrounds, we ended our task with a common perspective. We believe that open, competitive markets have enormous capacity to generate benefits for individuals, firms and society at large. And we believe that, if the beverage alcohol system is to generate significant additional returns for the people of Ontario, it will be necessary to make the system much more open and competitive while continuing to ensure the socially responsible sale of alcohol.

In our view, the current system falls far short of this vision. It is dominated by three monopolies: the government-owned Liquor Control Board of Ontario (LCBO); Brewers Retail Inc. (BRI), owned by Ontario's three largest brewers; and the winery retail stores, most of which are owned by two wineries. Our goal, then, was to determine how the system could be restructured to expand competition while protecting public interests.

We fully accept that beverage alcohol is not an ordinary consumer product. The original reason for government intervention in the sector was harm reduction. This rationale is as valid today as it was in 1927.

However, we studied other jurisdictions and found that a variety of regulatory strategies can ensure social responsibility in the sale of beverage alcohol. It is not necessary for government to own and operate wholesale and retail facilities to do this. Our research tells us that active enforcement and retail prices are the most effective means for controlling access to alcohol. We would build these fundamental strategies into a transformed beverage alcohol system.

When the LCBO was originally created, retail ownership was a means to the end of alcohol control. Now retailing has almost become an end in itself. The government is deeply involved in a complex, fast-changing business. While the LCBO has evolved

positively in recent years, our work has convinced us that the LCBO will find it financially challenging to keep pace with broader consumer and retail trends over the long term while maintaining or increasing its dividend to the province. This is not a line of work that government should be in.

We consulted with industry stakeholders and found they face many anomalies and constraints, not surprising for a system cast in the mould of the 1920s. While those who do business in the sector have learned to make the system work, many see opportunities to make it work better. For example, we were told that the LCBO's listing practices limit the availability of niche products and the products of small wine, beer and spirits manufacturers.

Over the decades, the government has come to rely on substantial revenues from the beverage alcohol system, which currently generates more than $1.5 billion a year to help fund health care, education and other public priorities. Part of our mission was to determine if more government revenue could be generated by the system. Our finding, after close analysis with our financial advisors, is that it could.

Our fundamental conclusion is this: To create an open and competitive system, maximize government revenue and protect social responsibility and other public interests, we unanimously recommend that the government withdraw from retail and wholesale operations and implement a licensing system for the retailing and wholesaling of beverage alcohol in Ontario.

Here is how such a system could work:

On the retail side, licences to retail the full range of beverage alcohol products for a fixed term would be auctioned individually to the highest bidders. Each package up for auction would also include the business assets of an LCBO store. Stores could be moved within geographic zones. A beverage alcohol outlet could be located within an existing retail establishment (such as a grocery store), provided that the existing premises and the beverage alcohol outlet met licensing requirements recommended in this report.

On the wholesale side, up to 10 licences to wholesale the full product range province-wide for a fixed term could be auctioned. The LCBO's warehouses would be included in the auction.

The government would collect the auction proceeds in instalments over the term of the licence. At the end of the term, licence-holders would be required to re-bid in a new auction. In this way government – and taxpayers – would receive additional value regularly and permanently.

To protect social responsibility, the new beverage alcohol system would

- maintain approximately the present total number of retail outlets province-wide and limit the number of outlets in geographic zones;
- set strict site requirements for beverage alcohol retail outlets, and regulate their opening hours, to ensure that alcohol is not treated as an ordinary consumer product;
- continue to enforce a minimum-price policy for beverage alcohol products;
- establish a comprehensive regulatory regime that would
  - ensure that all beverage alcohol in Ontario is monitored by the government, from importing or manufacturing through wholesale, distribution and retail sale and service on licensed premises;
  - set clear operating rules for the wholesale and retail licence-holders and for all licensed establishments, with progressive sanctions for non-compliance;
  - require sales staff of the licensed retailers to participate in ongoing social responsibility education and awareness programs and to complete approved testing on responsible sales practices;
- increase funding for inspections, enforcement and adjudication to ensure timely imposition of sanctions.

To implement the transformed system, the government would collect its charges on beverage alcohol when the products enter the wholesale channel. And the existing players – BRI and wineries with retail stores located off the winery site – would be offered opportunities to make a smooth transition to the new environment.

Under our strategy, the government would retain the equivalent of all the revenue it currently obtains from the system and, after a transition period, would reap $200 million or more annually from

the auction process. This would mean more money for hospitals, schools and other public needs.

Moreover, an open, market-driven system would put the focus on the consumer. It would deliver more convenience, broader selection and competitive prices. New wholesale and retail channels would give small producers and makers of niche products greater access to the marketplace – boosting economic growth.

For decades, Ontario has made minor repairs to the beverage alcohol system when a complete overhaul was needed. Change is overdue. In our view the Ontario government should focus its role on effective regulation and fundamentally transform the beverage alcohol system for the 21st century.

LIST OF RECOMMENDATIONS

System Restructuring

To provide the benefits of a more open, flexible and competitive market to the people of Ontario, including increased revenue from the system, we recommend that the government of Ontario do the following.

- Fully restructure the beverage alcohol system by
  - focusing the government's role on regulating access to beverage alcohol;
  - withdrawing government from retail and wholesale operations and supporting the creation of a competitive marketplace;
  - auctioning licences to qualified bidders to permit them to retail a full range of beverage alcohol products within defined geographic zones for a fixed term;
  - auctioning licences to qualified bidders to permit them to wholesale a full range of beverage alcohol products province-wide for a fixed term;
  - limiting the number of licences and market share of any one bidder.
- Give the existing private sector participants – Brewers Retail Inc. (BRI) and off-site winery retail stores – the opportunity to participate in and transition to the new system by
  - including their retail outlets in the auction process, or
  - if they choose not to participate in the first auction round, allow them to continue current operations under a new licence for 10 years.
- Redesign the system of alcohol charges to establish flat per litre charges. Collect these charges when the products enter the wholesale channel.
- Apply a reduced rate of government charges to the products of small producers of beer, wine and spirits, based on an annual production threshold. Maintain the existing provincial charges on sales at winery retail stores.

Social Responsibility

To ensure a high level of social responsibility for the consumption, storage, distribution and sale of beverage alcohol in the new system, we recommend that the government do the following.

- Maintain approximately the current total number of beverage alcohol retail outlets province-wide and set limits on the number of outlets in each geographic zone. Set criteria for adjusting the number of outlets province-wide and within each zone to reflect such factors as population shifts, consumer convenience and the outcome of the auction process.

- Set strict site requirements for new beverage alcohol retail outlets and regulate their opening hours to ensure that alcohol is not treated as an ordinary consumer product.

- Continue to enforce a minimum-price policy for beverage alcohol products.

- To support the restructured system, establish a comprehensive regulatory regime that would
  - ensure that all beverage alcohol in Ontario is monitored by the government, from importing or manufacturing through wholesale, distribution and retail sale and service on licensed premises;
  - set clear operating rules for all wholesale and retail licence-holders and for all licensed establishments, with progressive sanctions for non-compliance;
  - require sales staff of licensed retailers to participate in ongoing social responsibility education and awareness programs and to complete approved testing on responsible sales practices.

- Increase funding for inspections, enforcement and adjudication to ensure timely imposition of sanctions.

Regulatory Enforcement

To streamline and modernize the framework for enforcement of alcohol-related regulations, we recommend that the government move to quickly implement changes that would lead to

- reform of the adjudicative hearing process for liquor licence violations, and
- more effective legislation and enforcement responses regarding drinking by minors.

Reuse and Recycling

To support environmental stewardship, we recommend that the government do the following.

- Ensure continuation of a deposit-return program for refillable beer bottles, with bottle return rates at least as high as at present, and require all retailers selling beer to participate.

- Undertake an independent study of the life cycle of beverage alcohol containers, focusing on different management systems (e.g., bottle return/reuse, Blue Box/recycle) in an effort to determine the best approach for Ontario's containers.

I. INTRODUCTION

The 2004 Ontario budget announced that the government would review major public assets to determine whether they are being managed effectively and efficiently and are providing the maximum return to the citizens of Ontario. On January 11, 2005, as part of this commitment, the government appointed an expert panel to review the sale and distribution of beverage alcohol in Ontario – the Beverage Alcohol System Review Panel. Brief biographies of the Panel members appear as Appendix A.

Mandate and Principles

We were specifically directed to provide advice and recommendations on

- how to optimize the wholesale and retail systems and distribution of beverage alcohol to consumers while protecting public interests;
- how to provide responsible consumer access to points of sale;
- the appropriate roles and responsibilities of government in the beverage alcohol marketplace; and
- any related matters that we felt appropriate with respect to Ontario's beverage alcohol wholesale, retail and distribution systems.

As well, the government established five principles to guide the review. These were

- safeguarding socially responsible consumption, storage, distribution and sale of beverage alcohol;
- providing convenience, variety and competitive prices for consumers;
- maximizing value to taxpayers;
- ensuring responsible reuse and recycling practices; and
- promoting Ontario's products.

While the Panel had a broad mandate, certain related issues were beyond the review's scope. The government did not specifically ask us to consider changes to the current liquor licensing framework, such as the minimum drinking age and the licensing of bars, restaurants and manufacturers (including their on-site retailing). Nonetheless, we felt it appropriate to comment on issues that stakeholders raised with us.

Why a Review?

Beverage alcohol in Ontario is an $8-billion-a-year business. It contributes more than $1.5 billion a year to the provincial treasury, roughly two-thirds of that from the Liquor Control Board of Ontario (LCBO), to help fund key public priorities such as health care and education.

A review of Ontario's beverage alcohol system is long overdue. The current system is essentially an artifact of the post-Prohibition era of the late 1920s. The LCBO was established and opened its first stores in 1927. At that time the government also negotiated with the brewing industry to set up a distribution and retail system for beer, which has evolved into today's Brewers Retail Inc. (BRI).

The beverage alcohol system changed slowly and in a piecemeal fashion over the decades. As a result, the system is extremely complex, involving a number of public and private-sector players with strictly defined roles in a highly regulated environment. Appendix C provides a fuller description of the participants in the system and how it is structured.

Looking at the system today, one of our first conclusions was that it is characterized by inefficiencies, trade-offs and inequities that we believe limit its benefits to Ontario.

This report reflects our review of the system – the first comprehensive look since its creation almost eight decades ago – and sets out what we regard as essential measures to update and rationalize it.

Consultation and Research

In fulfilling our mandate, we met with a wide range of stakeholders in both one-on-one meetings and roundtable sessions. And we received a significant number of submissions, in writing and online. These aspects of the consultation process are described in more detail in the following chapter. We deeply appreciate the thoughtful input from the many people whose views helped to shape our deliberations.

We also engaged a team of advisors and consultants to help us investigate issues, develop and evaluate options and prepare our report. They assisted in conducting a review of beverage alcohol systems in Ontario and 18 other jurisdictions, a review of recent literature on social responsibility and a review of current retail trends.

The Panel's Perspective

As a panel, our goal was to develop balanced advice that would help the government deliver the maximum return to the people of Ontario and address the priorities of social responsibility, consumer convenience, reuse and recycling and the promotion of Ontario products.

Our task has not been an easy one. Right from our initial briefings we were struck by the complexity and size of Ontario's beverage alcohol system, as well as by its unrealized potential. We have come to understand that the various stakeholders in the system have learned to operate as effectively as they can within its constraints. We have also come to believe, however, that it is time to address those constraints.

The Panel members brought diverse skills and professional experience in both the public and private sectors to bear on the review of this complex system. Despite our different backgrounds, we ended our task with a common perspective that we want to express at the outset.

We believe that open, competitive marketplaces have an enormous capacity to generate benefits for individuals, firms and society at large. And we believe that if the beverage alcohol system is to produce significant additional returns for the people of Ontario, it will be necessary to introduce greater openness and competition throughout the system while protecting social responsibility and other public interests.

In our view the current system is neither open nor competitive. It is dominated at the retail level by three channels: the LCBO, BRI and Ontario wine retailers with off-site stores. Each of these channels is, to some extent, vertically integrated: that is, each has at least one other role as wholesaler or producer.

To a large extent, the structure of the system reflects two long-held views: first, that government must regulate access to alcohol to ensure social responsibility; and second, that the best way to do so is to strictly limit the number of participants in the system, with a major direct operational role for government. While we agree completely with the first premise, many other jurisdictions have proven that there are more effective alternatives to the second.

Our challenge, then, was to determine how the system could be restructured to introduce competition while respecting the principles set out by the government to guide our efforts, particularly the need to control access to alcohol.

We believe we have accomplished this mission. Our strategy balances all of the priorities that underlie this review and seeks the best possible outcome for consumers, industry and the government. It supports a more open and competitive market and allocates risks and returns appropriately.

Following are the key elements of our recommended strategy:

- **The role of government should focus on controlling access to beverage alcohol.** In support of this role, government should increase its investment in enforcing regulations in this area. We also believe, although this is somewhat beyond the scope of our mandate, that the current regulatory framework requires streamlining and updating.

- **The government should auction fixed-term licences to the private sector to operate wholesale and retail beverage alcohol businesses.** This would increase the return to government, bring market forces into play, make the system more flexible, and increase consumer choice and convenience.

- **The government should collect beverage alcohol–related revenue as early as possible in the supply chain** (that is, at the wholesale level). There is no need to own wholesale and retail facilities to collect this revenue.

Acting on our strategy, the Ontario government would retain the equivalent of all the revenue it currently obtains from the system and, after a transition period, reap $200 million or more annually in additional value.

We realize that this solution calls for major change to the system. It is our belief that change on the margins can provide only marginal gains for consumers, the industry or public revenues. In essence, the current system is the result of eight decades of change on the fringes.

Structure of the Report

The balance of this report is organized as follows:

- Section II, Setting the Stage, outlines what we heard through stakeholder and public input, highlights the major issues and puts them in context, and discusses key public policy considerations – including a look at retail trends and the conclusions of a separate LCBO operational review.

- Building on this foundation, Section lll, Our Strategy for Transforming Ontario's Beverage Alcohol System, sets out what we believe should be the system's new direction. It explains how we narrowed the choices, presents our recommended model and rationale, and describes the other options we considered.

- Finally, Section IV, Conclusion: Towards a Competitive System, recaps our findings and sets out a vision for the system in the future.

II. SETTING THE STAGE

What We Heard: Stakeholder and Public Input

We sought to hear from a wide spectrum of views and adopted an active consultation strategy. Elements included news releases encouraging comments through formal submissions, letters and e-mail; a web site that included a discussion paper and electronic feedback form; and stakeholder meetings and roundtable sessions.

In all, we received more than 50 formal written submissions, 40 online feedback forms, 100 e-mail submissions or comments and 30 letters. The review's web site recorded more than 3,000 unique visits.

Consultations

In February and March 2005, we met with a broad range of stakeholder groups, either in one-on-one meetings or in roundtable sessions. These meetings helped us to gather information and learn about the specific concerns of various parties.

One-on-one meetings took place with the principal players in the beverage alcohol business: the LCBO, Canada's National Brewers (representing BRI), Spirits Canada and the Wine Council of Ontario. We also met in this format with law enforcement associations and the labour unions representing the employees of The Beer Store (BRI's retail store name) and the LCBO.

Our three roundtable sessions allowed a cross-section of stakeholders to enter into a wide-ranging discussion with Panel members on a specific theme.

The first, focusing on business and industry issues, involved small brewers, grape growers, hospitality groups and agents for imported wines, spirits and beer.

Those with concerns about public health and social responsibility were invited to our second roundtable. We heard that the current system does a reasonable job of limiting alcohol consumption and therefore reducing the risks arising from excessive use.

At the third and final roundtable, issues of responsible reuse and recycling were at the forefront. Environmental groups expressed strong support for an independent evaluation of the economics of the beverage alcohol container life cycle as a basis for policy decisions on recycling.

These meetings made it clear that all stakeholders share a commitment to working together in the current structure, even though they often believe the system could or should be improved. For example, public health groups discussed how they collaborate with the LCBO, BRI and other business stakeholders to further public education on responsible drinking. Import agents pointed out that they work closely with licensed establishments (e.g., bars and restaurants) to expand the selection of beverages consumers can enjoy when dining out. The LCBO and BRI mentioned their joint efforts to increase awareness of the beer bottle deposit-return program.

Key Stakeholder Issues

Social Responsibility

Public health associations, labour unions and law enforcement representatives told us that social responsibility issues must receive serious consideration before any changes are made to the current beverage alcohol system. All three groups expressed the view that social responsibility is one of the strengths of the current system.

It is clear to us that stakeholders share the conviction that the beverage alcohol system must protect social responsibility. We fully agree.

Access, Opportunity and Flexibility

Our stakeholder discussions also demonstrated that after 78 years of evolution, today's system is neither as rational nor as flexible as most stakeholders think it should be. Nonetheless, it is our conclusion that stakeholders have learned to function within the system – even though that means adopting or maintaining business practices that would not have been pursued in a more open economic environment.

Through our consultations we came to understand that stakeholders have an investment in today's system. It did not surprise us when they said they favoured only modest changes to the status quo. While we appreciate these concerns, we find it difficult to agree that major change should be avoided at all costs.

Stakeholders doing business in the system expressed concerns that the system as currently structured lacks the flexibility needed for 21st century retailing.

- Small producers and import agents are frustrated because access to the retail market is essentially limited to one or two channels, depending on the product.

- While brewers can reach consumers through either the LCBO or BRI, spirits producers and most wineries can reach consumers only through the LCBO, apart from retail outlets at the production site and their web sites.

- Ontario's smaller vintners are concerned because there are limits on how far the LCBO can go towards putting every Ontario wine on its shelves. Small Ontario brewers and agents for niche products face similar constraints.

- Import agents whose products do not make it to the LCBO's stores report that they can build consumer demand only slowly, by placing customer orders through the LCBO's Specialty Services Department.

- BRI is owned by the three largest brewers in Ontario, and some small brewers worry about how much visibility their products can get when a major wholesale and retail channel is managed by their competitors.

All in all, industry participants are of two minds about today's system. They value the scale and power of its distribution systems but chafe at its inflexibility. Looking forward, they share a common concern that their growth potential in Ontario is only as good as their access to the marketplace.

As a result of these concerns, some members of the industry told us they would like to see new wholesale or retail channels added to enable them to build and respond more quickly to consumer demand. Specifically, import agents and licensed establishments believe an alternative warehouse and distribution service could meet their specialized needs. And wineries and import agents feel that adding a few private specialty stores could provide a retail venue for small-volume and niche products that the LCBO does not carry.

Industry stakeholders generally accept that flexibility should be an important feature of the system's design. Again, we agree. We believe the beverage alcohol system should be responsive and allow reasonable access and opportunity for all.

Other Issues

In meeting with the Panel, stakeholders raised a number of issues relating to service at licensed establishments. While these matters fall outside the scope of our review of the wholesale, distribution and retail system, we take this opportunity to bring these issues to the government's attention.

Regulatory Enforcement

Police groups and licensed establishments both raised concerns about the enforcement of liquor laws.

Most important, they called on the government to ensure that liquor licence hearings are conducted as quickly as possible, pointing out that lengthy delays weaken the deterrent effect of sanctions.

Licensed establishments also proposed the creation of progressive or staged sanctions. These would include, for example, automatic written warnings or fines for first offences instead of the hearings process.

Concerns were raised about sales to minors. While police are confident that the current system is effective in preventing such sales at retail outlets, they note that this is difficult to measure because regulations do not allow the police to involve minors in compliance checks.

Licensed establishments feel it is unfair that they bear the most risk when minors use false identification, especially when technology is making false documents more sophisticated and harder to detect. Although it is an offence under the Liquor Licence Act to use false identification, we are told that minors are rarely penalized for doing so. While minors provide evidence against the establishment that accepted the false document, they generally escape consequences themselves.

We believe that timely enforcement and meaningful sanctions are critical, in today's system and in any future system. The government must address these issues no matter what decision it makes about the system's structure.

We encourage the government to closely monitor the adjudicative performance of the Alcohol and Gaming Commission of Ontario (AGCO). We also recognize that continuing to prevent minors from buying beverage alcohol in a constantly changing entertainment and retail environment is a growing challenge. Meeting this challenge will require the best regulatory tools available.

We are confident that, given the right regulatory framework and increased enforcement resources, retailers, licensed establishments, the AGCO and the police can continue to protect social responsibility.

Recommendation

To streamline and modernize the framework for enforcement of alcohol-related regulations, we recommend that the government move to quickly implement changes that would lead to

- reform of the adjudicative hearing process for liquor licence violations, and
- more effective legislation and enforcement responses regarding drinking by minors.

Tourism Development

Associations representing licensed establishments – bars, restaurants and other premises serving beverage alcohol – advocated changes to the current liquor licensing regulations to help them compete with other tourism destinations. Specifically, they would like to see the regulations expanded to allow the resort sector to offer beverage alcohol in all-inclusive travel packages.

We observe that Ontario's wineries, breweries and distilleries play a valuable role in offering tourists a destination experience. We believe that the hospitality and beverage alcohol industries could benefit from combining their promotional efforts. We understand that the government plans to review the Liquor Licence Act and regulations, and we invite the government to take this opportunity to consider changes that support tourism development.

Public Policy Considerations

In addition to undertaking consultation, we examined several public policy considerations in depth and took our conclusions into account.

Government Involvement in the System

One of the key questions the government asked us to consider from the outset was this: What is the appropriate role for government in the beverage alcohol system?

At present, the provincial government, including the LCBO and AGCO, has multiple roles:

- first receipt of imported beverage alcohol,
- monitoring retail prices for beverage alcohol,
- setting and enforcing minimum prices for beverage alcohol,
- collecting alcohol-related charges,
- wholesaling and warehousing,
- retailing directly to consumers,
- promoting Ontario's beverage alcohol products,
- educating the public about responsible use,
- developing and enforcing various statutes and laws relating to the abuse of alcohol, and
- licensing bars, restaurants and manufacturers and regulating their practices.

An interjurisdictional study we commissioned shows that only one of 18 other jurisdictions examined – Nova Scotia – has a stronger government presence in the beverage alcohol marketplace than does Ontario.

Central to our review was the question of how well these roles support the goals of consumer choice and convenience; flexibility for suppliers; an open, competitive and economically sound system; an appropriate return to government; and social responsibility.

We firmly believe there is an ongoing role for the government in regulating access to beverage alcohol. This role is unequivocally in the public interest and is non-negotiable. It is the bedrock premise on which all our other conclusions rest.

We came to this conclusion because beverage alcohol is not an ordinary consumer product. Excessive use puts both individuals

and society as a whole at risk. After research and review of other jurisdictions, however, we came to believe that it is not necessary for government to take on the roles of wholesaler and retailer in order to mitigate those risks.

With that new understanding, we thought it would be useful to look more closely at the government's current role as wholesaler and retailer, and how evolution in the sector may change the picture in future.

Operational Review of the LCBO

In line with the regulatory role of government, the LCBO's original mission was to control the importing, wholesaling and retailing of liquor. Retail ownership was simply a means to this end.

Now, however, retailing has almost become an end in itself; the body charged with responsibility for controlling alcohol in Ontario has become one of the largest distributors of alcohol in the world. The LCBO has an interest in selling more beverage alcohol products. It actively sets out to do this through sophisticated and inviting store environments, advertising and even consumer rewards programs.

This is not meant as a criticism of LCBO management. They are, in fact, doing exactly what the current system expects of them.

As part of its 2004 budget commitments, the Ontario government commissioned an independent third-party operational review of the LCBO in early 2005. The firm conducting the review was asked to assess the effectiveness and efficiency of LCBO operations in maximizing government revenue and to recommend areas where the LCBO's performance could be improved.

The operational review was conducted separately from the Panel's examination of the broader beverage alcohol system. However, we received a briefing on the findings.

The review found that the LCBO is a well-managed organization that has successfully transformed itself into a modern retailer. It also concluded, however, that the LCBO needs to become more aggressive in managing its cost structure.

While opportunities exist to improve the LCBO's performance, we believe that the fundamental challenge is a structural one, not an operational one. We must also express serious concerns about the LCBO's ability to remain on the leading edge in the future. These concerns are particularly strong on the retail side. Around the world the retail channel is undergoing rapid change that will increase business risk significantly.

Looking into the Retail Future

Our advisors found that around the world, successful retailers must constantly reduce costs while adopting new approaches to sharpen their focus on the customer. This calls for both flexibility and investment in innovation. In the beverage alcohol sector specifically, significant change in wholesale distribution and retail operations is happening internationally. At the retail level, the trend is towards localized, customized product assortments and more convenient locations.

The forces driving change include

- rising and shifting customer expectations about service quality, localized products and pricing;
- the reality that the current "big box" retail store model will mature, and new formats will be required;
- the need to improve productivity and lower costs instead of raising retail prices;
- the imperative to provide maximum value to owners, whether private-sector or government.

It is difficult for any beverage alcohol retailer, even the LCBO, with its monopoly position, to successfully balance these often competing forces. Changing lifestyles are driving consumer expectations about product selection and convenience in Ontario no less than in other jurisdictions.

At the same time, we believe that ongoing consumer resistance to price increases will add pressure to deliver better customer service at a lower cost. Retailers will need to improve supply chain networks, management and business processes, and supporting technology. As well, stores will feel the pressure to deliver both excellent service and high efficiency without higher costs. Deciding how to balance investments to improve both productivity and service levels will present a challenge.

The issue of social responsibility will remain a core priority in the beverage alcohol system. The public will expect this issue to be addressed in a meaningful manner even while the system strives to meet new consumer expectations.

In sum, retail dynamics are evolving rapidly. To meet consumer demands, major changes will be necessary in retail sizes, formats, locations and offerings. Retailers, including the LCBO, will need to invest in developing new concepts, renovating existing stores and adding new ones, and creating more efficient supply chains. In 2003–04, the LCBO invested more than $32 million in enhancing its operations. The evidence suggests that retailers will be required to increase investments of this type in the future. At the same time, they will have to cut their operating costs. This will call for nimble, innovative and focused players.

We view this as a very difficult environment for a government agency such as the LCBO. On the sales side, its retail operations have high labour costs and a high proportion of full-time staff compared with other retail and commercial enterprises. These factors will continue to challenge the LCBO's ability to cut costs and contain price increases, especially given the realities of labour relations in a monopoly. On the buying side, current policies do not allow it to take full advantage of its purchasing power or to benefit from business practices common in the private sector.

While the LCBO's performance could be improved, the changes this would call for on the policy front would be significant. Moreover – and for us, this is a critical point – improving the LCBO would not open up the system as a whole to greater competition, convenience and choice.

Other Participants in the System

To place the government's role in context, we also considered the roles played by the other participants in the system.

In the 1920s, when the foundation of the current system was laid, the obvious choice for controlling access to beverage alcohol was to strictly limit the number of parties that could distribute and retail the product, with a strong government presence in the marketplace.

The result was the creation of the government-owned LCBO, which was given exclusive control over the retailing of spirits and, at that

time, wine. During the same period, the Brewers' Warehousing Company Ltd. (BWCL), owned by the brewing industry, began to distribute beer to retail outlets owned by contractors.

Since then, the system has not altered greatly. In the 1940s BWCL purchased and consolidated contractors' outlets. In the 1960s the LCBO introduced agency stores, which are owned and operated privately, to serve smaller communities. Beginning in 1975, domestic wineries were allowed to open retail stores off the winery site, although international trade agreements subsequently froze the number of these outlets.

Today, as Figure 1 shows, Ontario's beverage alcohol system is characterized by a small number of players at the retail level that are owned primarily either by government or by producers.

Figure 1. Beverage Alcohol Retail Outlets*

Structural Change Necessary

Although we recognize that the government must control access to alcohol, and the current structure does achieve this, the question we found ourselves asking was whether the current structure is really the best when other important considerations – consumer choice, competitive pricing, convenience, returns to government and flexibility – are taken into account. This was key

in determining whether the current system strikes the best possible balance for the people of Ontario.

Looking at the entire system, including both its government-owned and producer-owned aspects, we believe that the fundamental challenge is structural – and not limited to the performance of the LCBO. We have concluded that to maximize the value to people in Ontario of the beverage alcohol system as a whole, top-to-bottom restructuring of all aspects – both wholesaling and retailing of wine, beer and spirits – is necessary.

Scaling back the government's operational or direct delivery role in the system necessarily implies enlarging the role of private competitors. We have no qualms about doing this. Specifically, our strategy for transforming the system calls on the government to grant, through auction, licences to wholesale and retail beverage alcohol for a fixed term.

To reap the benefits of that change, however, the government must fundamentally reconsider its role in the system. A system that is truly open to all responsible private-sector retailers and wholesalers that bid for and win licences from government should not include government-owned enterprises.

We recognize that any major change involves transitional issues, which some may prefer to avoid. Our concern, however, is that the above challenges will not fix themselves. Failure to modify the system now will only require more extensive and expensive change in the future.

Social Responsibility

One of the strengths of today's system, as we heard during our consultations, is its effectiveness in ensuring social responsibility.

A guiding principle for our review was the need to safeguard socially responsible consumption, storage, distribution and sale of beverage alcohol. We were also specifically asked to make recommendations on how to provide responsible consumer access to points of sale.

As well, our terms of reference directed us to consider how Ontario's beverage alcohol system compares to other jurisdictions both in Canada and internationally. We regard the various strategies

used to promote social responsibility as a crucial element in this comparison.

Given the significance and complexity of these issues, we sought outside expertise to help build our understanding. We commissioned the Centre for Addiction and Mental Health (CAMH) to review the literature on social responsibility and to synthesize the results. The CAMH enlisted international experts to help with the preparation of a comprehensive report outlining key research findings about social responsibility in the context of the beverage alcohol system.

We also retained the consulting firm Grant Thornton to undertake research on how 19 different jurisdictions across North America and around the world deal with beverage alcohol sale and control. The consultants examined a range of factors, and some of their findings concern social responsibility.

The Concept of Social Responsibility

Key points from the CAMH report can be outlined as follows.

- Beverage alcohol is an accepted part of modern Ontario society. Nearly 80 per cent of Ontarians report drinking alcohol in the previous year, most without harm to themselves or others. Thousands of jobs and substantial government revenues depend on the production, distribution and sale of beverage alcohol. And moderate alcohol consumption may confer health benefits in some cases.

- However, these advantages must be weighed against the health and social harm that can result from excessive alcohol use. Research demonstrates that immoderate consumption can contribute to illness, premature death, violence, accidents and lost productivity.

- Since the end of Prohibition, a key goal of government policy has been to find the right balance between the benefits of and the potential harm from beverage alcohol. The CAMH report points out that the concept of social responsibility, in the context of the beverage alcohol system, refers to policies and practices linked to the reduction of harm. We accept this definition.

- Canadian and European studies since 2000 have shown that if there is more drinking in a population, the risks of serious consequences are likely to grow. Therefore policies and practices that act to increase average or per capita alcohol consumption can be expected to increase alcohol-related harm, including fatalities.

- The CAMH report concluded: "... public health and safety policies that regulate accessibility to alcohol have beneficial implications for people with a wide range of drinking experiences and practices." We concur with these observations and believe that regulating access to beverage alcohol is and should remain a core function of government.

Interjurisdictional Study

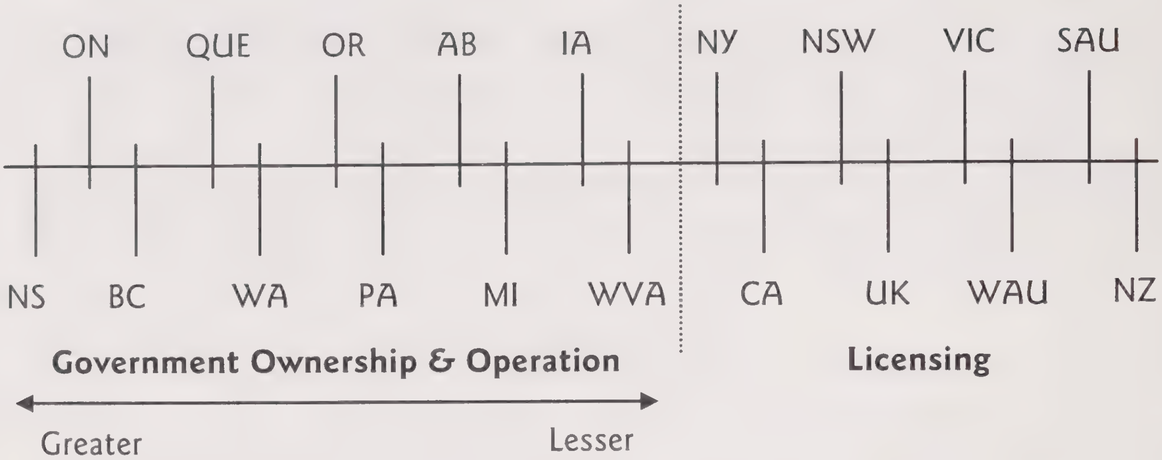
The Grant Thornton interjurisdictional review confirmed that because of the potential for abuse of beverage alcohol, most modern governments do not treat it as an ordinary consumer product, and have taken steps to regulate supply and demand. In fact, all 19 jurisdictions examined have placed some degree of control on the production and sale of beverage alcohol.

However, the interjurisdictional comparison found no single accepted approach to beverage alcohol control, with governments choosing from a number of different policy tools or levers. For the most part, differences between beverage alcohol systems are a function of the different social, economic and historical realities in each jurisdiction.

The Grant Thornton study found that a wide range of beverage alcohol systems can achieve essentially the same public policy objectives. In particular, extensive government ownership and operation of the system are not necessary to maintain social responsibility.

Based on the research of our consultants, we placed each of the 19 jurisdictions along a continuum of more or less government involvement in the beverage alcohol system. The spectrum ranged from state ownership and operation at one end to a licensing system – where the government licenses other players to import, distribute and sell beverage alcohol – at the other. In the middle, governments retained ownership over some wholesaling and retailing functions but outsourced or privatized others (see Figure 2).

Figure 2. Government Involvement in Beverage Alcohol System



Greater = Retail sales, distribution, importation are government owned and operated

Lesser = Retail sales primarily by private sector licenses; government retains ownership of importation and distribution

Licensing = Government role in retail sales, distribution and importation limited to issuing licenses/permits.

Alberta (AB)	New South Wales (NSW)	Oregon (OR)	Victoria, Australia (VIC)
British Columbia (BC)	New York (NY)	Pennsylvania (PA)	Washington (WA)
California (CA)	New Zealand (NZ)	Quebec (QUE)	Western Australia (WAU)
Iowa (IA)	Nova Scotia (NS)	South Australia (SAU)	West Virginia (WVA)
Michigan (MI)	Ontario (ON)	United Kingdom (UK)	

Government ownership and operation tend to be more common in North America, while countries such as the United Kingdom, Australia and New Zealand have gravitated to more arm's-length licensing systems. The licensing systems are designed to ensure government oversight of the system without requiring day-to-day government involvement in wholesale and retail operations.

The Impact of Retail Practices

As a panel, we carefully weighed the significance of specific retail practices – including pricing, outlet density and ownership.

Pricing

According to the CAMH report, there is overwhelming evidence that the price of alcohol – including taxes – is a powerful determinant of alcohol consumption and alcohol-related problems. Research cited by the CAMH shows that increases in the cost of alcohol to the consumer act to decrease consumption rates,

particularly among heavy drinkers, and thus decrease rates of alcohol-related problems. Conversely, decreases in the cost of alcohol to the consumer act to increase consumption rates, and thus increase alcohol-related problem rates.

We share the view that alcohol pricing is a key aspect of social responsibility. Therefore our strategy for transforming the beverage alcohol system maintains a minimum-price policy. Deep discount pricing at the retail level should be prohibited. While we envisage price competition in a more open marketplace, we are adamant that retailers not be allowed to sell beverage alcohol at prices below the minimum price set by the government. This approach is based on the recognition that pricing is one of the most effective tools for reinforcing socially responsible use of alcohol.

Outlet Density

The work the CAMH did for us also highlighted the potential impact of outlet density – the number of beverage alcohol retail outlets within a given area. Some of the most recent findings generally support a positive link between outlet density and alcohol consumption and alcohol-related problems.

These findings suggest the need for caution in expanding the number of retail outlets. Accordingly, our strategy for transforming the beverage alcohol system would carefully limit the number of beverage alcohol retail outlets across the province as well as within specific geographic zones. Our proposed approach would maintain approximately the current number of beverage alcohol retail outlets province-wide.

Ownership

Both the CAMH report and the interjurisdictional review examined the impact of private versus public ownership of retail outlets. Some public health research cited by the CAMH shows a slight correlation among private ownership, more retail outlets and higher consumption.

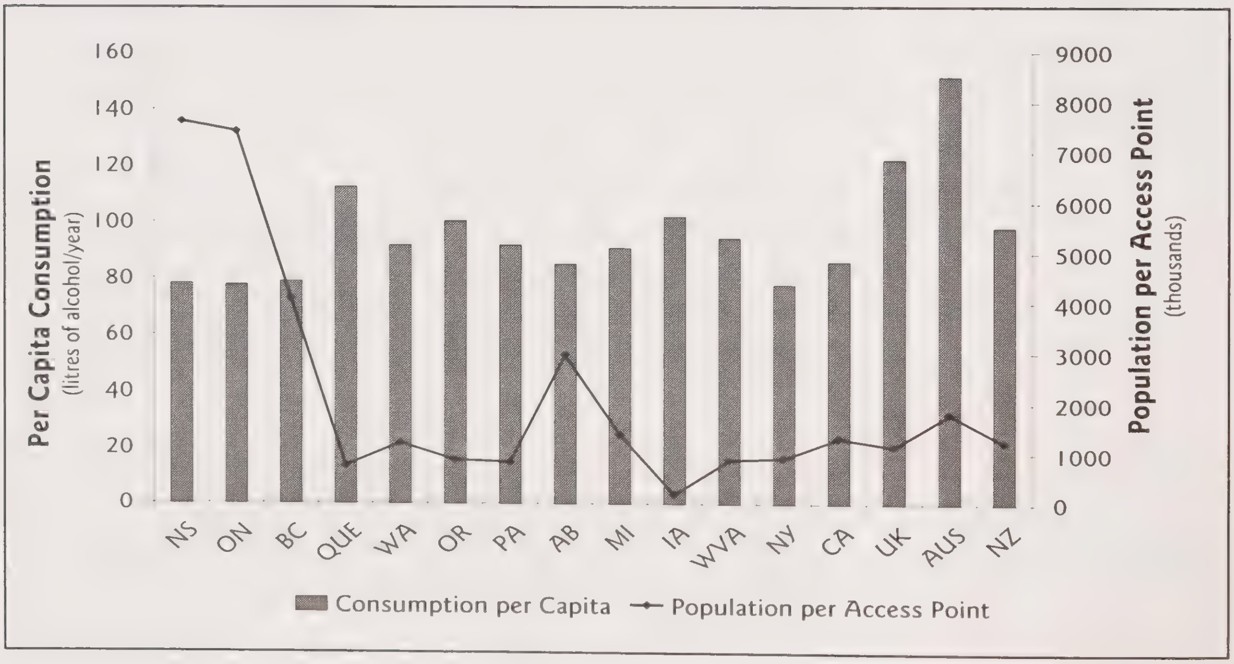
Consumption Rates – It is often assumed that beverage alcohol consumption increases as day-to-day operational involvement by government decreases. Grant Thornton's interjurisdictional comparison of consumption rates suggests that the actual reality is more complicated.

For example, Nova Scotia has about the same consumption rates as Ontario and British Columbia, even through it has a greater government ownership and operational presence in the marketplace. In Alberta, the privatization of retail beverage alcohol sales does not seem to have resulted in significantly higher overall per capita consumption rates than in the other Canadian jurisdictions reviewed (see Figure 3).

The overall data led us to believe that there is no conclusive link between consumption patterns and the type of control system in place. A variety of control systems have proven effective in maintaining social responsibility.

Access Points – The Grant Thornton interjurisdictional review confirmed that as governments have allowed more private-sector involvement in retail sales, the number of access points has increased. For example, after the introduction of privatization, Alberta went from 304 retail points of sale in 1993 to 1,087 points of sale in 2005. (The number of retail points of sale almost doubled between 1993 and 1995, with much more gradual annual increases

FIGURE 3. CONSUMPTION PER CAPITA AND POPULATION PER ACCESS POINT



thereafter.) British Columbia went from 796 points of sale to 1,029 points of sale after private retail sales were expanded in 2002.

However, some jurisdictions with licensing regimes (such as New York, California and the United Kingdom) actually have fewer access points per capita than several jurisdictions (such as Quebec, Pennsylvania and Oregon) with significantly more direct government involvement in the system (see Figure 3).

Our assessment of these findings is that the number of retail outlets should be limited and the best way to do this is through regulation and licensing. We propose to restrict the number of outlets, both province-wide and in defined geographic zones, in our strategy for transforming the system.

The Current Ontario Scene

Legislative Framework

Apart from reviewing the research on social responsibility and interjurisdictional comparisons, we also examined Ontario's current legislation and retail practices to control beverage alcohol.

The Liquor Control Act, the Liquor Licence Act and related regulations set out control mechanisms. These acts provide for the setting of minimum prices by product throughout Ontario and regulate the selling of beverage alcohol, making it an offence, for example, to sell to minors or people who are intoxicated. The Liquor Control Act gives the LCBO the right to import and sell liquor, establishing its role as first receiver of all alcohol imported into the province.

In our view, none of the above strategies depend on the current ownership structure of the industry. All of them could and would be continued under the restructuring strategy we propose. We firmly believe that the government must use its regulatory power to set and strictly enforce strong social responsibility controls.

Retail Store Policies and Programs

The three main retail channels in Ontario's beverage alcohol system – the LCBO, BRI and the winery retail stores – have implemented policies and programs to address social responsibility.

The LCBO and BRI have embraced social responsibility as a core value and to this end have articulated responsible-selling policies. All staff are expected to complete responsible-sales training programs, which include challenge and refusal practices for use with minors and intoxicated persons. In support of these efforts, in-store or cash-register signage sets out the policy of requesting identification from customers apparently under age 25. If valid identification is not produced, employees must refuse to complete the sale. Likewise, alcohol is not to be sold to an apparently intoxicated person. In the fiscal year 2003–04, the LCBO reported challenging more than 1.2 million customers, while BRI reported challenging more than 5.3 million people in the latest year.

It may be a mark of how successfully BRI enforces these social responsibility measures that the majority of people in Ontario – six out of 10, in a recent poll – believe that BRI's retail outlets are government-owned. With greater recognition that these stores are owned by major corporations, Ontarians would see that the private sector can do a good job in maintaining social responsibility – especially when backed up by active government enforcement and appropriate pricing.

Both the LCBO and BRI have sponsored public education initiatives to encourage socially responsible consumption, such as the development and distribution of responsible hosting and consumption guides. In addition, both the LCBO and BRI have formed close partnerships with advocacy groups – such as Mothers Against Drunk Driving (MADD) and the Ontario Community Council on Impaired Driving (OCCID) – to support media campaigns, fundraising programs and public service announcements and materials.

The Panel's Conclusion

The experiences elsewhere confirm that a variety of regulatory tools and approaches can protect social responsibility. There is no single "right" model, and it is up to Ontario to design what will work for this province.

In guiding that design, we note that our research shows that it is not necessary for government to own and directly operate wholesale and retail assets to ensure the socially responsible sale and use of beverage alcohol. Instead, active enforcement and retail pricing are the best means of encouraging socially responsible use of alcohol.

Applying this knowledge to shape the new system that we envision will ensure that Ontario continues to limit the potential harm from alcohol while reaping the benefits of a more open and competitive system.

We suggest that the government use the licensing process we propose to ensure and reinforce social responsibility standards for all retailers. We also urge the government to invest more resources in inspection, enforcement and adjudication to ensure compliance with existing and future beverage alcohol legislation and regulations. By doing so, it will ensure that social responsibility remains a top priority in a transformed beverage alcohol system.

Our recommendations on maintaining social responsibility in the new system that we propose appear in Section III of this report.

Promoting Ontario's Products

Promoting Ontario's products is a further principle that guided our deliberations.

The Ontario government takes an active role in promoting the products of domestic beverage alcohol industries, with the goal of creating jobs and spurring economic growth. It uses several different levers, including legislation, policies, funding for industry strategies, and LCBO programs.

Trade Agreement Framework

By signing the General Agreement on Tariffs and Trade (GATT) in 1947, Canada made a commitment not to discriminate against imported products. This commitment was renewed in 1994 when Canada joined the World Trade Organization (WTO). Similar commitments were made to the United States in the 1988 Canada-U.S. Free Trade Agreement and incorporated into the 1992 North American Free Trade Agreement (NAFTA). Under these trade agreements Canada and Ontario are obliged to give imported goods (including beverage alcohol) "… treatment no less favourable than that accorded to like products of national origin," as Article III.4 of GATT expresses it.

Trade disputes led to a further 1989 agreement with the European Union (subsequently updated in 2003) and a separate 1993 agreement with the U.S. As a result of these agreements, the winery retail store system, which sells only Ontario products, was allowed to continue, but the number of winery retail stores (located off the

winery site) was frozen at 290. As well, BRI was required to sell imported as well as domestic products.

Wine Legislation

Provincial legislation sets requirements and standards for Ontario wine production. In doing so, it promotes stability for domestic grape and wine producers and provides a strong regulatory program for increasing home and international recognition of Ontario's premium wines.

Two pieces of legislation set minimum requirements and premium standards for wine production. The regulation under the Wine Content and Labelling Act, 2000, requires all wine manufactured in Ontario to contain a minimum of 30 per cent Ontario grape or grape product in each bottle. The intent is to maintain an ongoing market for Ontario's grape producers. On the rare occasions when Ontario grape harvests have been severely reduced by winter weather conditions, the minimum requirement has been changed for a limited time to ensure that Ontario wineries can maintain production levels. Most recently, this has been done to ensure a sufficient supply of Ontario grapes to maintain production volumes of 100 per cent Ontario Vintners Quality Alliance (VQA) wine.

Through the Vintners Quality Alliance Act, 1999, the province legislated an appellation of origin system for Ontario wine. An appellation of origin system sets and enforces the quality standards a wine must achieve to identify itself as the product of a particular region.

During our consultations, Ontario's grape growers and some wineries expressed concerns about provincial wine content and labelling requirements and related marketing practices. They believe that consumers do not realize that some Ontario wineries manufacture and sell wines made from a blend of imported and Ontario grapes. They feel that information about imported content should be stated clearly on the wine label, and that these wines should not be marketed as Ontario wines in the LCBO or off-site winery retail stores. They also urged an increase in the 30 per cent minimum Ontario content requirement for wine manufactured in the province.

We encourage the Ontario government to continue working with the federal government on national wine labelling standards so

that consumers can make more informed purchases. Regarding the minimum Ontario content requirement, we believe that any change would alter the economics of the grape and wine industry. We encourage the government to revisit this issue following its decision on the future of the beverage alcohol system.

We agree with grape growers and wineries that the future of Ontario wine depends on increased consumer awareness of 100 per cent Ontario wine – and specifically wine bearing the VQA mark.

Government Policies

Any Ontario beverage alcohol manufacturer can sell its own products at a retail store located at the production site. In addition, Ontario wineries and small brewers may deliver their products directly to licensed establishments such as bars and restaurants, and small brewers may deliver directly to LCBO retail stores.

Sales at winery retail stores are assessed a 2 per cent government charge instead of the 58 per cent government markup and the $1.62 per litre levy on wine sold at LCBO retail outlets. Ontario wineries retain more revenue on these sales, boosting their ability to promote their products and reinvest in their businesses. The 2 per cent charge applies at both on-site winery retail stores and the off-site winery retail stores that have been continued under international trade agreements.

For both wineries and small brewers, direct delivery sales enable producers to build support for domestic products among licensed establishments through one-on-one relationships and quick fulfilment of orders. As with sales at winery retail stores, wineries keep more revenue from direct delivery of VQA wines. As well, for small brewers, direct delivery to licensed establishments and LCBO retail stores offers an alternative to the BRI distribution system owned by their competitors. Where it makes business sense to make their own deliveries, it offers small brewers the option of saving on BRI distribution fees.

Domestic brewers pay a per litre government fee on all beer shipped for sale from the manufacturing plant. Reflecting their smaller economies of scale, microbrewers producing less than 150,000 hectolitres annually (on average over five years) pay a reduced fee.

Industry Strategies

By funding industry strategies, the government helps domestic wineries and microbrewers build developmental capacity, increase consumer awareness and expand their home market.

Wine

In 2001 the government announced a $10 million commitment to support the Ontario wine industry's strategic plan through December 2004. The 2004 Ontario budget announced a further commitment of $2 million per year for five years beginning in 2005.

The goal of the Ontario Wine Strategy is to build on the successes of the 1990s by integrating marketing, tourism and trade initiatives to achieve sustained growth in the sector. The focus is on pursuing premium quality, investing in the VQA brand, nurturing wine tourism, increasing the availability of Ontario wines and forging partnerships within the grape and wine industry.

The government has also worked in partnership with the wine industry to implement the Wine and Culinary Tourism Strategy, with the objective of establishing Ontario as a quality wine and culinary tourism destination.

Beer

In the 2004 Ontario budget the government also announced a commitment of $1 million per year for five years to support the Ontario Microbrewery Strategy. This funding assists with implementation of the Ontario Craft Brewers' (OCB) strategic plan in four areas, research and benchmarking, marketing, training and education, and operating stewardship. A key priority is to develop a joint marketing strategy that will create a brand identity for Ontario craft brewers. The goal of the strategic plan is to increase the sales of Ontario microbrewery products, which in turn will generate new jobs and more investment.

LCBO Programs and Policies

The LCBO is a key retail channel for domestic wineries, microbrewers and distillers. LCBO retail and marketing programs increase consumer exposure and access to domestic products and represent an important element of the government's efforts to promote Ontario's products.

As part of the Ontario Wine Strategy, the Wine Council of Ontario and the LCBO have worked together on programs to expand the visibility of domestic wines at the LCBO. Initiatives include dedicated shelf space for VQA wines, a dedicated Ontario wine product manager, designated LCBO staff trained to educate consumers about Ontario wines, and targeted marketing and merchandising programs.

The LBCO has also assisted OCB with strategic planning, and OCB sections have recently been introduced in a number of LCBO stores. The LCBO includes craft beers in its product-knowledge training programs for staff.

The Panel's Conclusion

We heard clearly from stakeholders that ongoing or increased support for small producers is vital if this sector of the industry is to flourish. We firmly believe that government support for small producers is in the best interest both of the system as a whole and of consumers.

We note that the government has developed highly effective approaches to foster the growth of small producers through marketing and strategic planning assistance. We encourage the government to continue on this path.

To support small producers, our plan for a restructured system proposes that they be able to deliver products directly to licensed establishments where it makes business sense to do so.

We also support the concept behind the lower government charges on microbrewery products based on annual production levels. We suggest that in the new system the government extend this concept to cover small producers of beer, wine or spirits; that is, the products of small producers, would be eligible for a reduced rate of government charges. This reduction would apply to both imported and domestic products. The threshold defining "small producer" would be based on an annual production level.

We are convinced that a properly structured beverage alcohol system can help create an environment that nurtures small producers as they enter and then grow in the competitive marketplace we envision for Ontario.

Our recommendations for maintaining and improving the health of small producers in the new system we propose appear in Section III of this report.

Reuse and Recycling

Another principle guiding the review has been ensuring responsible reuse and recycling practices.

The three Rs – reduce, reuse and recycle – represent a hierarchy of preferred treatment. Ontario manufacturers and retailers have adopted a variety of practices and programs to reduce packaging, then to reuse if possible, and finally to recycle if necessary.

The beverage alcohol system has a deposit-return system for refillable beer bottles and uses the municipal Blue Box collection system for non-refillable glass containers – including wine, spirits and some beer bottles. As well, there is a deposit-return system for beer cans, which are non-refillable, and beer cans are also collected through the Blue Box program.

Provincial Policy Framework

The Ontario government has established a provincial waste-diversion policy framework designed to divert waste from landfills. The underlying legislation is the Waste Diversion Act, 2000, which established a corporation called Waste Diversion Ontario to develop and implement waste-diversion activities, including the Blue Box program. An organization called Stewardship Ontario administers the Blue Box program by setting and collecting fees from import agents and brand owners and distributing the funds to municipalities to offset the Blue Box program costs.

Since 2003 the LCBO has made a $5 million annual contribution to Stewardship Ontario to support the Blue Box program.

Beverage Alcohol Containers

Beer bottles are subject to a deposit-return-to-retail system run by BRI. This program is recognized as one of the most effective packaging management systems in the world, with consumers returning more than 96 per cent of the industry-standard refillable bottles sold. A 10-cent deposit is paid on each bottle at the point of purchase (usually the LCBO or The Beer Store) and is refunded when the bottle is returned to a BRI outlet. A typical bottle is refilled 10 to 15 times.

Standardized reusable containers are not employed for wine and spirits. Given the number of product offerings – well over 10,000 from more than 60 countries – implementing a deposit-return-reuse program would be a significant challenge. The current alternative is recycling through the municipal Blue Box system. Approximately 64 per cent of non-refillable LCBO containers are collected through the Blue Box program.

Improving the Recycling System

During our consultations we heard from stakeholders that the deposit-return system for beer bottles works well, but the recycling system for wine and spirits bottles does not. Stakeholders noted the poor quality of glass obtained through Blue Boxes. Largely multicoloured and broken by the time it reaches a processing facility, the collected glass has both high recycling costs and limited aftermarket appeal.

A different approach would be a deposit-return system where bottles are returned and sorted by glass colour. This alternative could produce a higher recovery rate, given the financial incentive to return the container. It could also generate a higher quality of glass for recycling and possibly identify some bottles for reuse. However, creating such a system would involve substantial capital costs.

Environment Levy

Another aspect of the provincial policy framework is the environment levy, imposed since the late 1980s on all non-refillable beverage alcohol containers sold in Ontario. This 8.93-cent per container charge is collected largely through the LCBO on behalf of the government. The winery retail stores and The Beer Stores also collect this levy on beverage alcohol sold in non-refillable containers.

Stakeholders noted that the proceeds of the environment levy form part of the general revenues of the Ontario government and are not earmarked for or dedicated to expenditure on the environment or environmental activities.

The Panel's Conclusion

The reduction, reuse and recycling of beverage alcohol containers is a complex subject. It is clear to us that, whatever changes are made to the beverage alcohol system as a whole, a deposit-return program for refillable beer bottles is essential.

Although the Blue Box program is heavily used by Ontarians, the Panel has heard that it is not working well for beverage alcohol containers.

Recommendations

To support environmental stewardship, we recommend that the government do the following.

- Ensure continuation of a deposit-return program for refillable beer bottles, with bottle return rates at least as high as at present, and require all retailers selling beer to participate.

- Undertake an independent study of the life cycle of beverage alcohol containers, focusing on different management systems (e.g., bottle return/reuse, Blue Box/recycle) in an effort to determine the best approach for Ontario's containers.

III. OUR STRATEGY FOR TRANSFORMING ONTARIO'S BEVERAGE ALCOHOL SYSTEM

How We Tackled the Job

The task of reviewing and developing recommendations on the beverage alcohol system in Ontario has been a complex one. At the outset, we concluded that a robust analytical approach would be required to inform our work and guide our conclusions.

With our advisors, we developed a detailed analytical process. The aim was to ensure a comprehensive and objective review that fairly evaluated all options against the government's objectives, competitive market realities, initiatives in other jurisdictions and feasibility of implementation.

We began by setting key objectives and priorities. We then undertook research and consultation to build our knowledge and deepen our understanding of the key business functions in the system.

From there, we identified a broad range of options for the system, including operational, governance and financial models. We successively eliminated those that did not achieve the key priorities and objectives, had too high a risk profile or did not pass financial tests. The feasibility of successful and timely implementation was our final criterion. See Appendix D for greater detail.

At the end of this process, one approach – the one we have recommended – was, in our view, clearly the best.

Narrowing the Choices

Our work with both stakeholders and experts – bolstered by research and analysis – helped us to develop a short list of five high-level options that merited additional investigation and analysis.

Our analysis of the short list of options was guided by three conclusions:

- While the government must retain ongoing responsibility for controlling access to beverage alcohol, it does not need to own and operate either retail or wholesale facilities in order to discharge this responsibility effectively.

- There is significant unrealized value within the system as a whole that could be captured for the benefit of all Ontarians.

- A more open marketplace would provide consumers with broader selection, greater convenience and competitive prices.

We recommend that government collect its charges for both domestic and imported products when the products enter the wholesale channel. By collecting charges as early in the supply chain as possible, the government would achieve greater transparency around its entitlement to charges and have a direct and immediate mechanism for collecting the charges. This would require a redesign of Ontario's system of alcohol charges. It would also involve creating a new government unit or agency to collect revenue from the system and administer responsibilities for first receipt of imported beverage alcohol.

The next sections of the report provide an overview of our preferred option and our rationale for recommending it. We then review the other major alternatives we considered and explain why we decided against them.

Our Recommended Option: A Licensing System

After consultation, research and analysis, we have unanimously concluded that the best approach for improving the beverage alcohol system is to introduce a licensing system. The government would grant, through an auction process, fixed-term licences to perform specified wholesale and retail functions, including those the government now performs itself. Of the options we considered, this one best met the goals of improving government revenue, increasing market access and flexibility for suppliers, widening consumer choice and convenience and enhancing market competition, while focusing the government's role on regulation.

Key Features

Retail Market

The government would define a number of geographic zones and establish strict limits on the number of beverage alcohol outlets, both province-wide and in each zone, based on criteria balancing social responsibility, customer convenience and population density. While the number of retail outlets per capita in Ontario is lower than in many other jurisdictions, we do not believe that the province requires a significant increase in the total number of outlets.

Auction Process

- The government would offer, at auction, licences to retail beverage alcohol within each defined zone. A licence would confer the right to operate one retail store. Each zone would contain multiple licences. Each licence would go to the qualified bidder making the highest bid.

- The bidding package for each licence would include the business assets of an LCBO store within the zone – that is, fixtures, fittings, real estate and leasehold improvements, as well as any lease obligations. Successful bidders could continue to operate the store at the existing site or relocate within the zone.

- BRI and wineries with off-site stores could include some or all of their retail outlets in the auction. If they did so, they would receive an appropriate portion of the auction proceeds.

- A Beverage Alcohol Retail Licence would confer the right to market a full range of beverage alcohol products within the specified zone for an initial 10-year term. We recommend that the government consider, based on the experience of the first licence term, reducing subsequent licence terms to five years. At the conclusion of each term, the retail licences in each zone would expire and bidders would take part in a new auction. Prior licensees would have the same status as other bidders.

- The government could adjust the total number of licences within each zone at the end of each licence term.

- The government could collect the proceeds of the auction in instalments over the term of the licence. Retailers would also be required to pay an annual licence fee to help defray the cost of the licensing system.

- Bidding would be open to parties who satisfy qualifying conditions such as experience, financial capacity, personal and business integrity and security requirements.

- Qualified parties might include individuals or organizations planning to operate stand-alone beverage alcohol stores, existing retailers planning to include a beverage alcohol outlet

within an existing retail establishment (for example, a grocery store), BRI, wineries or other manufacturers.

Terms and Conditions

- To ensure sufficient, robust competition in the marketplace, retail licensees could be limited as to
  - the percentage of outlets they could own province-wide,
  - the percentage of outlets they could own within a zone, and
  - the percentage of the corporate entity's outlets currently in Ontario.

- Licence terms would include performance standards such as staff training and education in meeting legal and other requirements to maintain social responsibility.

- To further support social responsibility, there would be strict site requirements for beverage alcohol outlets, including a separate entrance, separate cash registers and separate staff for the beverage alcohol retail business. Beverage alcohol would not be sold with other products, and sales would be monitored by dedicated beverage alcohol staff. Hours of operation would continue to be regulated by government.

- Large retailers would have the option of placing a beverage alcohol retail outlet within the footprint of their existing business. However, the footprint would have to cover at least a minimum specified area and the beverage alcohol business would have to be walled off from the rest of the operation and meet the other site requirements set out above.

- Although licences would cover the full range of beverage alcohol products, retailers could choose to specialize.

- Retailers choosing to sell beer would be required to participate in a deposit-return system for refillable beer containers.

Implications for Existing Participants

- Those BRI stores not included in the auction would be granted a 10-year licence to retail beer only in the geographic zone where they are located. At the end of the term, the licence would expire. BRI could then choose to bid in the next auction

for a full-product-range retail licence in that zone or close the outlet.

- Those winery retail stores not included in the auction would be granted a 10-year licence to retail wine produced by their owners. The licence would allow relocation to other geographic zones. At the end of the term, the wine store owner would have the option of bidding for a full-product-range licence in the next auction or closing the outlet.

- Where BRI or wineries choose not to include their retail outlets in the initial auction process, the government could offer additional licences at auction to ensure an appropriate number of full-product-range licences in each zone.

- The products of small producers of beer, wine and spirits would be eligible for a reduced rate of government charges. This reduction would apply to both imported and domestic products. The threshold for defining “small producer” would be based on an annual production level.

- Sales at off-site winery retail stores not included in the auction and sales at on-site winery retail stores would continue to benefit from the existing 2 per cent provincial charge. These sales would not be eligible for the reduced rate of government charges on products of small producers.

- Winery, distillery and brewery retail stores located at the manufacturing site would continue operating as they do today under the current licensing terms and conditions.

- Operators of LCBO agency stores would continue to operate. Until included in the licensing system, they would pay a fee for the opportunity to retail beverage alcohol. If an agency store surpassed a pre-established sales volume threshold, the licence would be auctioned and the operator could bid to continue the business.

- Small producers would be able to sell products directly to beverage alcohol wholesalers and licensed establishments, while other producers would sell through the wholesale channel.

- Retailers would be able to sell to other retailers and licensed establishments on a cash-and-carry basis, but only wholesalers would be allowed to ship products to these outlets.

Wholesale Market

- Wholesalers would participate in a province-wide marketplace, competing for the business of retailers and licensed establishments on the basis of service, product selection and price.

Auction Process

- The government would award a limited number of wholesale licences – probably no more than 10 – through a competitive auction process.

- All LCBO wholesale assets would be included in the auction.

- A Beverage Alcohol Wholesale Licence would confer the right to wholesale a full range of beverage alcohol products across the province for a specified term – initially 10 years. As with retail licences, we recommend that the government consider changing subsequent terms to five years, based on the experience of the first 10 years. At the conclusion of each term, the wholesale licences would expire and would be re-auctioned. Previous licence-holders would have the same status as other bidders. At the end of each term, the government could adjust the total number of licences.

- Licences would be awarded to the highest qualified bidders. The government could collect the proceeds of the auction in instalments over the term of the licence. As on the retail side, wholesalers would also be required to pay an annual licence fee.

- Bidding would be open to parties who satisfy qualifying conditions such as experience, financial capacity, personal and business integrity and security requirements.

- Qualified parties might include, but would not be limited to, manufacturers, retailers and existing wholesalers and distributors in the beverage alcohol or other commercial sectors.

Terms and Conditions

- No organization or person could hold more than one beverage alcohol wholesale licence, but the holder of a wholesale licence could also hold one or more retail licences.

- Licence terms would include performance standards such as bonding of staff and security of facilities.

- Wholesalers would be required to have open listing policies. That is, they would be required to accept all products that manufacturers want to list with them.

Implications for Existing Participants

- BRI would be offered two options. It could bid for one of the licences to wholesale the full range of products or it could continue to operate as a beer-only wholesaler for a 10-year term. In this capacity, it could service retained Beer Store outlets, new retailers and licensed establishments. At the end of the term, BRI could not continue to operate as a wholesaler without bidding for a wholesaler's licence.

Discussion

Revenue Impact

By pursuing this option, the government would preserve the equivalent of its present revenue stream from charges on the commodity and also realize significant additional revenue by auctioning the rights to wholesale and retail beverage alcohol. It is anticipated that costs would be linked with the transition to the new structure. We estimate that, following a transition period, the licensing approach could yield incremental value to the province of $200 million or more annually.

Based on a high-level review, we believe that, over the long term, the financial returns for this option are considerably better than for any of the other alternatives we examined. By auctioning the right to wholesale and retail beverage alcohol, the government would gain a substantial portion of the unrealized value in the system, which would be used to support health care, education and other priorities. We expect that this option would encourage mass-market organizations (such as grocery stores) to enter the system. We expect their participation to result in substantial operational efficiencies. It is expected that the government would realize a portion of these efficiency gains through the auction process.

Healthy Competition

The current beverage alcohol market is dominated by vertically integrated monopolies that combine retail, wholesale and, in the case of beer and wine, manufacturing activities. This option would transform the beverage alcohol system and foster healthy wholesale and retail competition for the first time since 1927.

Ontarians would be able to purchase beverage alcohol from a wide variety of socially responsible retailers. A more open marketplace would keep prices competitive and increase selection and convenience for consumers. In order to attract and keep customers, retailers would strive to give consumers what they want.

In addition, a more flexible and open wholesale system would go a long way towards addressing the access concerns raised with us by small producers and import agents. These stakeholders pointed out that they are at a disadvantage in getting products in front of consumers in the current system. This option would require wholesalers to distribute any product offered to them. Small producers and import agents would thus have multiple distribution channels to get their products to the retail marketplace.

The Panel's Conclusion

We recommend the option described above. Our view is that this approach is the best path forward for Ontario because it

- eliminates the business and financial risks that go with government ownership and operation of a large integrated retail and wholesale enterprise,
- generates greater ongoing revenue for taxpayers,
- offers consumers broader product selection, more convenience and competitive prices,
- makes the system more flexible by replacing three monopolies with an array of wholesalers and retailers, and
- provides producers with more opportunities and better market access.

Recommendations

To provide the benefits of a more open, flexible and competitive market to the people of Ontario, including increased revenue, we recommend that the government of Ontario do the following.

- Fully restructure the beverage alcohol system by
  - focusing the government's role on regulating access to beverage alcohol,
  - withdrawing government from retail and wholesale operations and supporting the creation of a competitive marketplace,
  - auctioning licences to qualified bidders to permit them to retail a full range of beverage alcohol products within defined geographic zones for a fixed term,
  - auctioning licences to qualified bidders to permit them to wholesale a full range of beverage alcohol products province-wide for a fixed term, and
  - limiting the number of licences and market share of any one bidder.

- Give the existing private-sector participants – Brewers Retail Inc. (BRI) and off-site winery retail stores – the opportunity to participate in and transition to the new system by
  - including their retail outlets in the auction process, or
  - if they choose not to participate in the first auction round, allowing them to continue current operations under a new licence for 10 years.

- Redesign the system of alcohol charges to establish flat per litre charges. Collect these charges when the products enter the wholesale channel.

- Apply a reduced rate of government charges to the products of small producers of beer, wine and spirits, based on an annual threshold production. Maintain the existing provincial charges on sales at winery retail stores.

THE CONSUMER'S VANTAGE POINT: WHAT A TRANSFORMED SYSTEM COULD MEAN

The consumer would be the focus of a transformed beverage alcohol system. Within the bounds set by regulation, consumers would ultimately decide, through the marketplace, what products are offered, where they are sold and how much they cost.

Here is a picture of how the transformed system could look to consumers when it is fully in place.

More Convenience

The total number of beverage alcohol retail outlets province-wide would remain about the same as today, but most outlets would offer spirits, wine and beer. Having more full-product-range stores would be more convenient than today's system, where many outlets offer only beer or wine. Consumers could do all their beverage alcohol shopping in one place.

In the new system, grocery stores and other large retailers could locate a beverage alcohol outlet within their existing businesses, provided certain conditions were met. (For example, the beverage alcohol outlet would have to be walled off from the rest of the operation and have its own specially trained staff.) The implementation of a store-within-a-store concept would enable consumers to save time through one-stop shopping.

Agency stores would continue as part of the new system. So would the retail stores located on the sites of breweries, wineries and distilleries.

More Choice

The new system would give consumers more variety and choice – in an open market, retailers would be competing for customers on the basis of selection.

While retailers would receive full-product-range licences, they could choose to specialize. Boutique liquor stores might well open in some neighbourhoods. For example, stores could specialize in product categories such as Ontario VQA wines, single malt Scotch or craft beers.

Competitive Prices

In the new system, consumers would also benefit from competitive prices. There would be limits on the number of retail outlets any one business could own, so competition would be strong. Retailers would vie for customers not only through convenience and selection, but also in price.

The government would maintain a minimum-price policy to prevent deep discounting. But otherwise, price competition would prevail. For example, if a large retailer secured a volume discount from a wholesaler, the savings could be passed on to the consumer.

In Short. . .

A transformed beverage alcohol system would mean increased convenience, a more varied selection and competitive prices for consumers.

Social Responsibility

To ensure a high level of social responsibility for the consumption, storage, distribution and sale of beverage alcohol in the new system, we recommend that the government do the following.

- Maintain approximately the current total number of beverage alcohol retail outlets province-wide and set limits on the number of outlets in each geographic zone. Set criteria for adjusting the number of outlets province-wide and within each zone to reflect such factors as population shifts, consumer convenience and the outcome of the auction process.

- Set strict site requirements for new beverage alcohol retail outlets and regulate their opening hours to ensure that alcohol is not treated as an ordinary consumer product.

- Continue to enforce a minimum-price policy for beverage alcohol products.

- To support the restructured system, establish a comprehensive regulatory regime that would
  - ensure that all beverage alcohol in Ontario is monitored by the government, from importing or manufacturing through wholesale, distribution and retail sale and service on licensed premises;
  - set clear operating rules for all wholesale and retail licence-holders and for all licensed establishments, with progressive sanctions for non-compliance;
  - require sales staff of licensed retailers to participate in ongoing social responsibility education and awareness programs and to complete approved testing on responsible sales practices.

- Increase funding for inspections, enforcement and adjudication to ensure timely imposition of sanctions.

A Phased Approach: Retain LCBO Wholesale

We recognize that the government may prefer to withdraw from beverage alcohol operations in stages to facilitate an orderly transition to a more open system.

We believe it would be possible to phase in our recommended option along the following lines.

Key Features

- The government would retain the LCBO's wholesale operations while still withdrawing from retail operations by auctioning all LCBO retail outlets as outlined above. That is, the LCBO would be restructured into a purely wholesale enterprise.

- The government would establish a wholesale licensing system and proceed with auctioning a limited number of licences (probably no more than 10) to private wholesale operators as proposed above.

- As a wholesaler, the LCBO would compete with private-sector wholesalers to deliver services to beverage alcohol retailers and licensed establishments.

- The rest of the option remains the same.

Discussion

Retaining the LCBO as a wholesaler could help smooth the transition to a fully private retail system. The LCBO has developed strong relationships with manufacturers worldwide and has a solid understanding of Ontario's consumer market. These attributes could well benefit beverage alcohol retailers who are just starting up. As a wholesaler, the LCBO should be able to maintain a steady supply of products to the new retailers entering the system.

However, there are also some substantial risks, including workforce redeployment issues, retraining costs, staff retention, governance and the potential for declining profitability in a competitive environment.

Implementation

We want to make clear that restructuring the beverage alcohol system cannot be done overnight. In our view, it could take between 18 and 24 months to restructure the system in an orderly manner.

Next Steps for Government

This report sets out a strategic vision for a transformed beverage alcohol system in Ontario. To make our vision a reality the government would need to take the necessary next steps, including detailed policy analysis, implementation planning and establishment of new operating procedures.

As well, substantial legislative changes would be necessary. For example, changes to the Liquor Control Act and the Liquor Licence Act and the related regulations would be essential before any licences could be auctioned.

As well, it would be necessary to redesign the system of alcohol charges in Ontario to allow the government to collect charges when products enter the wholesale channel. As part of this redesign, the government should establish flat per litre charges for various categories of beverage alcohol products.

Considerations for the Industry

Implementation of our strategy would require the industry to make adjustments to how business is conducted.

Our plan offers options to BRI and wineries with off-site retail stores for making the transition to the new licensing system.

In the new environment, beverage alcohol producers would find it imperative to build commercial relationships with a range of new retailers and wholesalers. Doing so could be a challenge for some smaller producers, who would need to develop new marketing skills and approaches.

Redesigning the system of alcohol charges would have an impact on current business models. Producers might have to adjust their business strategies to remain competitive.

THE PRODUCER'S VANTAGE POINT: WHAT A TRANSFORMED SYSTEM COULD MEAN

An open, competitive beverage alcohol system would increase market access, flexibility and opportunities for producers of wine, beer and spirits. Since the present system heavily favours the largest producers, these changes would especially benefit smaller producers.

New Marketing Channels

Currently the LCBO decides what products to carry, and tends to favour those that generate a high sales volume. Wineries and distilleries producing small volumes or specializing in niche products have few options if their offerings are not listed. The same goes for import agents representing foreign products. The new system would change this by replacing the LCBO's monopoly with an array of new retail and wholesale channels.

Under the new system, wholesalers would be required to follow an open listing policy. That is, they would be obliged to accept all products that producers want to list with them, giving producers, at their commercial risk, a pipeline into an open market.

At the same time, the ownership of retail outlets would be dispersed instead of concentrated in three vertically integrated monopolies, as is the case now. Multiple retailers competing for customers are much more likely to be open to carrying products made in small quantities, as well as specialty and niche products.

BRI already has an open listing policy for beer, but many small and micro breweries would prefer not to rely on a wholesale/retail channel run by their competitors, the three owners of BRI. Under the new system they would have other wholesale and retail options. Moreover, small producers could deliver their products directly to licensed establishments such as bars and restaurants if they choose to.

Advantages for Producers

The proposed system would have features designed to make it work for current industry participants, large and small.

During transition, BRI and the wineries owning off-site retail stores could include some or all of their existing outlets in the licensing auction and receive a portion of the proceeds. Stores not auctioned could continue to operate as they do now for 10 years; however, they would likely face increasing competition.

On-site and off-site winery retail stores not included in the auction would continue to benefit from the existing provincial charges on their sales.

The products of small producers would be eligible for a reduced rate of government charges. This reduction would apply to both imported and domestic products. The threshold defining "small producer" would be based on an annual production level.

A Stronger Sector

We believe that future prospects Ontario's beverage alcohol producers' depend on open access to the marketplace and fair opportunities to compete for customers. The more flexible beverage alcohol system we propose would increase access and opportunity for all.

Other Options Considered

In addition to the recommended option, we examined four other major alternatives in depth:

- retain and improve the LCBO
- divest the government of the LCBO
- form a joint venture with BRI and the winery retail stores
- introduce additional competition into retail and wholesale markets.

The following section reviews each of these.

Retain and Improve the LCBO

As discussed earlier, a management consulting firm completed an operational review of the LCBO. This process highlighted several areas where the government could derive more revenue from the LCBO without restructuring the beverage alcohol system. We considered this approach.

Key Features

- LCBO wholesale and retail operations would continue to be owned and operated by the government.
- BRI and off-site winery retail stores and other retailers would continue to operate as they do today.
- To enhance financial performance and realize more value for taxpayers, the government would consider the policy issues and then direct the LCBO to implement, as appropriate, changes recommended by the operational review. The government would proceed with steps that would lead to efficiencies and revenue opportunities.

Discussion

This option has the advantage of providing the government with additional revenue without disrupting the existing beverage alcohol system. The government would retain all the revenue it currently obtains from the system and realize additional revenue by finding operating efficiencies and new revenue opportunities within the LCBO.

While this option could generate more revenue for the government, it would rely to some degree on increasing alcohol consumption or raising prices on some products – factors that our analysis held

constant. Retaining the LCBO would fail to capture the significant value that would flow from licensing private operators to wholesale and retail beverage alcohol for fixed terms. As a result, this option would effectively leave revenue untapped and "on the table." We believe this value should accrue to the people of Ontario.

A further problem with this option is that it fails to bring about system-wide change. Under this option, competition would remain limited at both the wholesale and retail levels. LCBO, BRI and winery retail stores would continue to face limited pressure to compete on the basis of price, selection or consumer convenience.

This option also does not address the access concerns some small producers and import agents raised with us. These stakeholders would continue to face challenges in getting their products in front of consumers.

Finally, this option requires the LCBO to continue to undertake regular investment in building and maintaining retail and wholesale facilities in a very challenging business environment. The LCBO, and hence the government, would retain all the business risks inherent in running a multi-billion-dollar enterprise.

The Panel's Conclusion

We do not recommend this option.

In our view, the government and people of Ontario can achieve better results over the long term through system transformation rather than through incremental change to the LCBO. We believe that a more open and competitive system is the best direction forward for Ontario.

Divestment of the LCBO

The LCBO has built up significant value over the years through its monopoly position in the system. One option would be to monetize (exchange for money) this value.

We feel it is inappropriate to include in any monetization the amounts that legitimately belong to government from the sale of alcohol. Monetization would include only the commercial profits from the LCBO's wholesale and retail operations.

Key Features

We have identified a number of ways in which the government could monetize the substantial value of the wholesale and retail operations of the LCBO.

In any monetization option it would be important that the government put in place the regime we have recommended to collect as much of its revenue as possible when beverage alcohol products enter the wholesale system.

A transaction could be structured so that the government retained some or all of the revenue it currently receives through the LCBO's annual dividend. The government could then monetize all or part of the LCBO's remaining future cash flow or value.

All the divestment options assume that

- the government would divest itself of substantially all the risks and rewards of ownership and operation of the LCBO's business;
- the government would act only as regulator in an oversight and enforcement role;
- the new owner would assume a monopoly position (currently held by the LCBO) in the market.

We looked at three potential approaches through which the government could divest itself of its interest in the LCBO.

Sale to an Authority

An authority is generally characterized as

- a business or service operation serving the public interest;
- governed by
  - specific enabling legislation, and
  - an independent board of directors (not controlled by government);
- empowered by a delegation or other legal agreement assigning specific rights and responsibilities to the authority (together with appropriate sanctions for non-compliance);
- typically constituted as a corporation without share capital, so there are no designated owners – it acts in support of the public good and in fulfilment of its stated objectives;

- financially self-sustaining and acting autonomously with respect to government;
- operating on a non-profit basis.

The beverage alcohol authority would

- be established by government under legislation;
- buy the LCBO business from government at the estimated fair market value;
- raise all of its capital in the form of debt, to the extent that it requires financial capital for business/asset acquisition and/or operating purposes (since there is no share capital, there is no equity);
- be at risk for the ongoing pre-established scope of business, which could include operating (volume, product, mix, pricing, labour, etc.), financial and other typical business risks.

Sale to Single Buyer

As the sale of a monopoly business, this is essentially a single en bloc transaction (although there could be variations to maximize value).

- A for-profit buyer could be
  - a strategic buyer who may see value in rationalizing and integrating the operations and assets of the LCBO into an existing complementary business – at the buyer's risk, or
  - a financial buyer who may see value in rationalizing and owning the LCBO as an investment.

- Sale to a single buyer would typically take place through a private-market auction transaction in which the LCBO business (assets or shares) would be offered for sale, under specified terms and conditions, to one or a few qualified bidders for the highest price.

- Bidders might include large institutional investors (e.g., pension funds, life insurance companies, investment funds) or industry investors.

- The successful bidder would own, finance and operate the business at its own risk, under legislation and agreements delegating to the bidder specified rights and responsibilities (with appropriate remedies for non-compliance).

Sale to Broad-Based Public Ownership

Sale to broad-based public ownership could occur, for example, through an initial public offering of share capital or through an income trust.

- An appropriate capital and legal structure would be determined for the LCBO's business.

- A broad-based public offering of all or part of the equity of this new LCBO business entity would be made through an appropriate vehicle, such as an income trust or share offering.

- The new entity would be governed by specific, enabling legislation and an independent board of directors (not controlled by government), and empowered through a delegation or other legal agreement assigning specific rights and responsibilities (together with appropriate remedies for non-compliance).

- The sale could represent an interest in all or part of the business, depending on such factors as market timing (to ensure the government receives the most value) and government preference for maintaining ownership to some degree.

- The new owners would be at risk in the financing and operations of the business.

- Buyers could include individual investors, institutional investors and others.

Discussion

Each of these different approaches to divesting of the LCBO's wholesale and retail assets has pros and cons in terms of potential return and technical implementation details, but for the purposes of our analysis their implications are essentially the same.

By pursuing this option, the government would sell all or a portion of the commercial profits from the LCBO's wholesale and retail operations for a large one-time payment. The government would give up any claim to the proportion of the LCBO's commercial profits monetized and to any future growth in that profit.

Under this option there would be no increase in competition among wholesalers and retailers of beverage alcohol. Instead of the publicly owned LCBO dominating the sale of alcohol in Ontario, as is currently the case, a privately held monopoly would dominate. Otherwise the beverage alcohol system would continue to operate essentially unchanged.

This option would not address the access concerns that small producers and import agents raised with us. These stakeholders would have to negotiate with the privately owned monopoly to get their products before consumers. The new retail monopoly might or might not perceive selling these products as making business sense.

The Panel's Conclusion

We do not recommend any of these options.

In our opinion, under any of these options the government and the people of Ontario would be trading a sizable continuing cash flow stream for a one-time lump-sum payment. In addition, these options do not increase consumer choice, promote competitive prices or offer increased convenience. Nor do any of these models make the system more accessible or flexible. In effect, under all these options one monopoly is exchanged for another monopoly. This, we feel strongly, is not in the broader public interest.

Joint Venture

In today's system, the LCBO, BRI and the off-site winery stores perform nearly identical functions in providing beverage alcohol products to consumers. In fact, their retail stores are sometimes located across the street from one another. But limited competition and separate business objectives prevent these players from capitalizing on supply chain and retail efficiencies.

The formation of a joint venture could enable participants to combine and rationalize assets, reduce duplication and build on corporate strengths. In seeking ways to unlock and capture system-wide value, we examined the joint venture option.

Key Features

- The LCBO, BRI and/or the off-site winery retail stores would create a joint venture operation for some or all elements of the system.

- The assets and operations of the LCBO, BRI and the off-site winery retail stores would be transferred to the new venture at fair market value.

- The joint venture would selectively rationalize LCBO, BRI and off-site winery retail store facilities, product offerings and locations.

- The government would act as regulator in an oversight and enforcement role.

Discussion

Under this option the government would convert its position in the LCBO into an interest in a new entity – a public/private partnership with a monopoly right to wholesale and/or retail all beverage alcohol in Ontario. The government would become one of a few shareholders with a voice in running the joint venture and would receive a portion of the profits. This option would likely result in substantial operational efficiencies, as duplicate wholesale, retail and head office functions would be rationalized. As a partner, the government would share in these gains.

This option would enable the government to retain an ownership interest in the retailing and wholesaling of beverage alcohol and should provide an opportunity to take full advantage of potential system synergies.

However, under this option there would be no competition in the beverage alcohol system. As the only beverage alcohol wholesaler and retailer in Ontario, the joint venture would have no need to compete on the basis of price, selection or consumer convenience.

This option would not address the concerns that small producers and import agents have expressed about market access. These stakeholders would have to negotiate with the joint venture to get their products before consumers. The new retail monopoly might or might not perceive selling these products as making business sense.

The joint venture option would leave the government with significant retained risks by virtue of being co-owner of the joint venture.

The negotiations to create the joint venture would be complex. Major implementation and operational challenges would also arise as the government and its private-sector partners learned to work together.

The Panel's Conclusion

We do not recommend this option. Reduced choice for consumers and producers, less flexibility and access, and the overall anti-competitive thrust of the concept make the joint venture unattractive. The implementation and governance complexities of this option also make it unappealing.

Additional Competition

Perhaps one of the most frequently raised options is that of allowing more retailers and wholesalers to compete in today's system. On the surface, adding new retailers and wholesalers seems to offer the best of all worlds, blending the flexibility of an open, competitive marketplace with the service offered by the current retailers.

Under this option, the government would license retailers and wholesalers to compete with the current operators (i.e., the LCBO, BRI, winery retail stores and other retailers). Licences would be issued to new operators for specific terms, with conditions as described in Our Recommended Option.

Key Features

- LCBO retail and wholesale operations would continue to be owned by the government.
- BRI and off-site winery retail stores and other retailers would continue to operate as they do today.
- The government would auction new beverage alcohol retail licences to qualified bidders to establish stores offering a full range of beverage alcohol products.
- The government would auction wholesale licences to qualified bidders to wholesale a full range of beverage alcohol products across the province.

Discussion

Under this option a limited number of new retail stores and/or wholesale operations would be introduced to the marketplace. The government would generate some incremental revenue through the auction process.

Our analysis indicates that, in the absence of significant increases in consumer consumption, the introduction of more retail and wholesale competition into the current marketplace would challenge the profitability of some LCBO retail outlets or activities such as warehousing. It is probable that the new licensees would have much lower operating costs than the LCBO. It is likely that forcing the LCBO to engage in price competition would result in downward pressure on the government's annual dividend. It is unlikely that this decrease in LCBO-generated revenue would be offset by the new revenues the government would receive through the auctioning of a limited number of beverage alcohol retail and wholesale licences.

This option would foster greater competition at the wholesale and retail levels. In order to win and keep customers, the new operators would probably strive to offer a broad range of products and services at attractive prices. Placing new wholesalers and retailers in the same market with the LCBO, BRI and winery retail stores should result in more selection and convenience for consumers and make prices more competitive.

This option, over the short term at least, would have the advantage of not requiring a complete restructuring of the beverage alcohol system. On the other hand, our analysis suggests that the new retailers and wholesalers would likely win market share quickly from the current participants – the LCBO, BRI and the winery retail stores.

This option would be a step towards addressing the access concerns of small producers and import agents. These stakeholders would gain new wholesale and retail options for getting their products in front of consumers.

The LCBO would still be required to invest in retail and wholesale facilities. And the LCBO and the government would retain significant risks in the face of potentially declining profits.

BRI and the winery retail stores might also experience reduced sales volumes caused by the introduction of new wholesalers competing in the hospitality market and new retailers competing for consumers.

The Panel's Conclusion

We do not recommend this option, even though it initially seemed to have some potential as a middle-of-the-road position between a more open and competitive licensing-based approach and today's system. In our opinion, however, it would significantly erode the value available from the system. This more piecemeal transition would involve risks for potential entrants because their competition would be a government entity, which would reduce their bids in the auction. Once competition appeared, the revenues of the LCBO would fall, and because it lacks the flexibility to lower its high cost structure, returns to the government would decline. An orderly transition that clearly allocates risks and returns at the start is the only way to achieve full value from an open marketplace.

The Bottom Line

Of the five options we evaluated, we believe the licensing system offers the best way forward for Ontario because it would create an open, competitive, consumer-focused marketplace.

Each of the other change options leads to outcomes we find unacceptable in terms of our mandate and the needs of the people of Ontario. After careful consideration, we unanimously concluded that our recommended option has the most potential to realize maximum value from the beverage alcohol system.

IV. CONCLUSION: TOWARDS A COMPETITIVE SYSTEM

We are confident that our recommended option would deliver significant benefits for the people of Ontario by transforming Ontario's beverage alcohol system.

The government should be using 21st century strategies to fulfill its indispensable role of safeguarding social responsibility in the sale, distribution and use of beverage alcohol. We are proposing that the Ontario government withdraw from ownership and operation of wholesale and retail beverage alcohol business, and instead create a regulated but competitive marketplace.

Like virtually everyone we consulted, we agree that social responsibility is one of the strengths of the current system, and we understand that alcohol is not just an ordinary commodity. But we do not believe that the current system is the only way of controlling this product.

As we have learned from the experiences of other jurisdictions both in North America and overseas, a wide variety of approaches has succeeded in limiting the potential for alcohol-related harm while reaping the benefits of a substantial financial return that can be invested in public priorities. There is no single "right" approach. It is up to Ontario to design its own.

In shaping an Ontario-made system, we have paid close attention to what we heard during our consultations with stakeholders. Apart from the emphasis on social responsibility, the most powerful theme was the need to increase access, opportunity and flexibility in the system. All but the biggest producers worry about barriers to the market that cast a shadow over their future ability to reach customers and to respond to changing consumer expectations.

Throughout our work, we have been mindful of the five principles the government established to guide our review. Our strategy for transforming the beverage alcohol system would deliver results in each of these areas.

First, social responsibility. We find that active enforcement and retail pricing are effective strategies for alcohol control. These strategies would be hallmarks of the beverage alcohol system we propose. In fact, we recommend strengthening enforcement by investing new resources and tightening some of the rules. We also recommend continuing with a minimum-price policy.

Second, maximizing taxpayer value. The recommended option produced what we consider the optimal financial returns (that is, the best financial result in the context of the stated objectives) for the people of Ontario.

Under our proposal, the government would keep the equivalent of its present revenue stream from the beverage alcohol system – approximately $1.5 billion a year. This money would be collected as products reached the wholesale level. The government does not need to operate a wholesale or retail business in order to collect revenue from beverage alcohol.

Under our proposal, the government would also obtain substantial additional revenue on an ongoing basis from the auctioning of wholesale and retail licences to the private sector. The successful bidders would pay for an opportunity to operate wholesale or retail facilities for a fixed term. We estimate that the licensing approach could yield incremental value to the province of $200 million or more annually, after a transition period.

Our strategy would remove the government from the risks and costs of running a commercial enterprise. It would unlock the latent economic value of the current beverage alcohol monopolies. Moreover, in the years ahead a more efficient beverage alcohol marketplace would create more value. The government and people of Ontario would share in these gains through the auction process.

Third, convenience, variety and competitive prices for consumers. Our plan would deliver them all by creating a more open marketplace.

We suggest that the government limit the total number of retail outlets in any future system, but allow each outlet to offer a full range of beverage alcohol products. This would increase consumer convenience. And since ownership would be widely dispersed, competition would be strong and prices stable. At the same time,

competition on the wholesale side would provide more channels for specialty products to get to market, thereby increasing consumer choice.

Fourth, responsible reuse practices. Through regulation, our strategy would continue today's effective deposit-return system for refillable beer bottles.

Finally, promoting Ontario's products. A restructured system would improve market access, opportunity and flexibility for Ontario beverage alcohol producers.

A major transition is never easy, but it would be worth it. The strategy we recommend would lead to more government revenue for health care and education; a sustained commitment to the socially responsible use of alcohol; increased economic growth based on greater access to markets; a renewed emphasis on responsible environmental practices; and wider choice, more convenience and competitive prices for consumers.

The present beverage alcohol system took shape at the end of Prohibition. For decades, Ontario has made minor repairs to the system when a complete overhaul was needed. In our view the government should focus its role on effective regulation, and restructure the system from top to bottom to establish a more competitive model.

After 78 years, change is long overdue. It is time to transform Ontario's beverage alcohol system for the 21st century.

APPENDIX A. BEVERAGE ALCOHOL SYSTEM REVIEW PANEL MEMBERS

John Lacey, Chair. John Lacey served as a member of the board of directors of the Liquor Control Board of Ontario (LCBO) from 1996 to 2001, and as vice-chair of the board in 2001–02. Currently chairman of Alderwoods Group Inc., he is a seasoned professional in the corporate sector, with more than 37 years of experience in senior executive positions. From January 1999 to January 2002 he was chairman of the board of directors of Loewen Group, of which he was a director from December 1998. Lacey has served as president and chief executive officer of the Oshawa Group, president and CEO of Western International Communications (WIC), president and CEO of Scott's Hospitality Inc., and vice-president, Operations, Loblaws Companies Ltd.

Gwen Boniface. As Commissioner of the Ontario Provincial Police (OPP), Gwen Boniface leads more than 7,000 uniformed and civilian members of the OPP. Commissioner Boniface earned a Bachelor of Arts degree from York University and a Bachelor of Laws degree at Osgoode Hall Law School. She was called to the bar in Ontario during 1990 and is a member of the Law Society of Upper Canada. In 1997 she was appointed to the Law Commission of Canada, an independent federal law reform agency that advises Parliament on how to improve and modernize Canada's laws. She is a recipient of the Humber College Alumnus of Distinction Award and was invested into the Order of Ontario in 2001 and the Order of Merit of the Police Forces in 2002.

Ann Dumyn. Ann Dumyn is currently managing partner of the private consulting company Arrawac Associates Inc., and corporate director for Aeroquest International Limited. Dumyn has 35 years' experience in business development, relationship facilitation, project management, social responsibility practice and financial services. Between 2000 and 2004 she was vice-president, Aboriginal and Northern Affairs, with SNC-Lavalin Inc., where she developed and managed business opportunities with governments, agencies and corporate partners in the power, mining and infrastructure sectors across Canada. Before joining SNC-Lavalin, Dumyn held a series of senior positions with the Bank of Montreal. She is a member of the board of governors of Lakehead University, a member of the board of directors of Habitat for

Humanity, Dufferin-Caledon, and a member of the board of trustees of the Royal Ontario Museum.

Suzanne Labarge. Suzanne Labarge is recently retired as vice-chair and chief risk officer of RBC Financial Group. She has more than 30 years' experience in commercial and corporate lending, audit, advanced portfolio management and market risk management. Labarge began her career with the Royal Bank, where she served in a number of executive positions. In 1985 she joined the federal government as assistant Auditor General, and two years later she was appointed deputy superintendent in the federal Office of the Superintendent of Financial Institutions. She returned to the Royal Bank in 1995 as executive vice-president, Corporate Treasury, before assuming the role of vice-chair and chief risk officer of RBC Financial Group in 1998. She also serves on the board of governors for McMaster University and is a board member and former chair of the Risk Management Association.

APPENDIX B. TERMS OF REFERENCE

- The government is seeking advice from an independent panel on Ontario's beverage alcohol system. The Beverage Alcohol System Review Panel will conduct a broad review of the existing system and develop recommendations for the government's consideration on ways to get better value for both consumers and the government. Historically, consumers place value on shopping convenience, product selection and competitive prices. The Province of Ontario relies on the beverage alcohol system for revenue that is used to fund provincial initiatives in health care, education and other priorities.

- The Review will be led by a four-person panel, one of whom will be the chair. None of the members will have an interest in the outcome of the review.

- The advice and recommendations of the Panel are to be guided by the following principles:
  - safeguarding socially responsible consumption, storage, distribution and sale of beverage alcohol;
  - convenience, variety and competitive prices for consumers;
  - maximizing value to taxpayers;
  - ensuring responsible reuse and recycling practices;
  - promoting Ontario's products.

- The Panel is to provide advice and recommendations on
  - how to optimize the wholesale, retail and distribution of beverage alcohol to consumers while protecting public interests;
  - how to provide responsible consumer access to points of sale;
  - the appropriate roles and responsibilities of government in the beverage alcohol marketplace;
  - any additional matters that the Panel feels are appropriate with respect to Ontario's beverage alcohol wholesale, retail and distribution system.

- The Review should include consideration of
  - the roles and responsibilities of
    - the Liquor Control Board of Ontario
    - The Beer Store (Brewers Retail Inc.)
    - winery retail stores;
  - the fiscal impacts to the Province of options or recommendations put forward;
  - how Ontario's beverage alcohol system compares to Canadian, U.S. and other jurisdictions.

- The Panel will conduct research, retain advisors, seek input from a broad range of sources and take actions that the Panel considers appropriate to conduct the review.

- The Review of the beverage alcohol system is part of the government's 2004 budget commitment to review major assets to determine whether they are being managed effectively and efficiently and whether they are providing the maximum return to the citizens of Ontario.

- The Panel is to provide its advice and recommendations in a written report to the Minister of Finance in spring 2005, on a date to be approved by the Minister.

APPENDIX C. THE BEVERAGE ALCOHOL SECTOR TODAY

Major Retail Channels

Despite nearly 80 years of evolution, the essence of Ontario's beverage alcohol system remains unchanged: The government is heavily involved in wholesale and retail operations.

However, by value the LCBO accounts for less than half of the Ontario beverage alcohol market. Two major private retail channels – the Brewers Retail Inc. (BRI) and winery retail stores – have evolved around the government retail system.

In all, the province has 1,670 retail points of sale for beverage alcohol, including the above channels, manufacturers' on-site stores and duty-free stores.

The three major retail channels are profiled below. (Figures provided are for the 2003–04 fiscal year, unless otherwise indicated.)

Liquor Control Board of Ontario (LCBO)

Established in 1927, the LCBO is a Crown agency reporting to the Minister of Public Infrastructure Renewal and financed by revenue from its operations. In fiscal 2003–04 the LCBO's net sales totalled $3.3 billion, while gross sales were $3.9 billion (including PST and GST). The LCBO earned net income of $1.045 billion.

The LCBO operates 598 corporate retail stores. It also authorizes 181 agency stores located within private retail outlets in rural areas and communities too small to support a corporate store.

The LCBO sells a full range of domestic and imported beverage alcohol products to consumers. The LCBO accounts for virtually all spirits sales in Ontario, 16.6 per cent of beer sales, 83.3 per cent of wine sales, and 58 per cent of sales of Ontario wine by volume.

In 2003–04 the LCBO had roughly 3,300 full-time and 3,300 casual employees. Unionized staff are represented by the Ontario Liquor Boards Employees' Union.

Brewers Retail Inc. (BRI)

Originally known as Brewers' Warehousing Company Ltd., BRI was formed in 1927 by a number of brewers to distribute their products to private retail outlets. Over the decades BRI has evolved into what is essentially a private monopoly for the retailing of beer in Ontario.

BRI today has two major shareholders – Molson Coors Brewing Company and Labatt Breweries of Canada – and one minor shareholder – Sleeman Breweries. In 2003–04 BRI had gross sales of $2.6 billion, accounting for 83.4 per cent of Ontario's beer sales by volume. Under The Beer Store banner, in 2003–04 BRI operated 445 retail stores selling imported and domestic beer to the public.

BRI has some 1,700 full-time and 4,000 part-time employees. Unionized staff are represented by the United Food and Commercial Workers Union.

Winery Retail Stores

In Ontario, licensed wineries own and operate 390 retail stores, which are authorized to sell only the products of the winery that owns them.

Currently 100 Ontario wineries operate an on-site store located at the winery. There are also 290 winery retail stores located off-site – either standing alone or housed within a larger retailer. Two wineries, Vincor International Inc. and Andrés Wines Ltd., operate the majority of the off-site stores.

Since trade agreements in the late 1980s and early 1990s, the number of off-site winery stores has been frozen. No further off-site stores can be added to the complement of 290 stores maintained under the trade agreements.

Winery retail stores account for about 16.7 per cent of total wine sales in the province and 42 per cent of sales of Ontario-produced wine by volume. For 2003–04 gross sales totalled $182 million.

Understanding Today's System

To understand Ontario's beverage alcohol system, it is useful to consider not only who the main players are, but also what they do and how their roles fit together.

In general, a beverage alcohol system resembles other packaged goods systems in which products are manufactured and then distributed through wholesale operations to retail outlets. The

key difference – and this is the case for beverage alcohol systems everywhere – is that governments closely regulate the manufacture, distribution and sale of beverage alcohol.

Regulatory Organizations

Three organizations regulate Ontario's beverage alcohol sector: the LCBO, the Alcohol and Gaming Commission of Ontario and Vintners Quality Alliance Ontario.

Liquor Control Board of Ontario (LCBO)

In addition to its business operations, the LCBO performs regulatory functions. Under federal legislation, all beverage alcohol imported into a province must be assigned to a designated provincial agency. In Ontario, this first receiver is the LCBO. The LCBO also issues and monitors authorizations for various parties involved in warehousing and distribution, monitors and enforces uniform prices throughout the province (to ensure that the same products sell for the same price regardless of retail channel), and sets minimum prices for all beverage alcohol.

Alcohol and Gaming Commission of Ontario (AGCO)

The AGCO is responsible for administering the Liquor Licence Act, the Wine Content and Labelling Act, 2000, and parts of the Liquor Control Act, as well as other statutes. It is a quasi-judicial regulatory agency with a mandate to regulate the sale, service and consumption of beverage alcohol in order to promote moderation and responsible use. It also regulates casino and charitable gaming.

Vintners Quality Alliance (VQA) Ontario

Operating under an administrative agreement with the government, VQA Ontario is a not-for-profit corporation with delegated responsibility for administering the Vintners Quality Alliance Act, 1999, and regulations. VQA Ontario enforces quality standards and an appellation of origin system for Ontario VQA wines.

Functions, Roles and Relationships

The following sections examine the beverage system in terms of the functions it performs, and then sketch the roles and relationships within Ontario's system.

Definitions

For the purposes of the review we adopted the following definitions of the key functions in a beverage alcohol system:

- **Manufacturing**: the production and packaging of beverage alcohol.
- **Importation**: the transfer of beverage alcohol into the province.
- **Wholesale**: the procurement and warehousing of products in bulk for the purpose of selling smaller quantities to individual retailers.
- **Distribution**: the shipping of products from the wholesaler to the retailer.
- **Retail**: the selling of products to the final consumer – the public.

Flow of Goods

The flow of goods in a typical packaged goods system can be easily illustrated. Figure 4 shows the steps in the transfer of goods from manufacturer to consumer.

The manufacturer, whether located in Ontario, another province or another country, sells and ships the product to a wholesaler. When a product is made outside Ontario or Canada, it must be imported through appropriate channels.

The wholesaler takes the product into its warehouse and applies a markup or charges to reflect the value of the wholesale and warehouse services, including storage and order fulfilment. The wholesaler then sells the product to a retailer.

Either the wholesaler or the retailer arranges for distribution, and a further charge is added to reflect the value of shipping services.

The retailer receives the product and adds a markup to reflect the value of the retail services, such as product selection and customer service, and the consumer pays the final retail price on the purchase.

Manufacturing

Brewers, wineries and distillers manufacture beverage alcohol in Ontario under a licence from the AGCO.

Ontario is home to 170 beverage alcohol manufacturers as of 2003–04:

- 120 wineries with 2,060 employees
- 38 breweries with 3,038 employees
- 12 distillers with 1,046 employees

The majority of manufacturers operate on-site retail stores. In addition to the 100 on-site winery stores, Ontario has 39 on-site brewery stores and three on-site distillery stores. As noted above, some wineries also sell their own products at off-site winery retail stores. And in some specifically authorized cases, manufacturers deliver directly to licensed establishments and duty-free stores.

Otherwise, the product flows to the wholesale level: Ontario manufacturers sell and deliver their products to the LCBO or BRI. Figure 5 shows the steps in the transfer of beverage alcohol from manufacturer to consumer in Ontario.

Importation

Manufacturers outside of Ontario may sell their products only to the LCBO, as the designated first receiver of imported beverage alcohol.

Wholesale, Distribution and Retail

In Ontario the wholesale, distribution and retail functions are highly integrated.

The LCBO functions as a wholesaler, distributor and retailer within its own supply chain, as does BRI. The LCBO and BRI also act as wholesalers to each other and to agency stores, licensed establishments and duty-free stores, depending on the type of product.

The LCBO has five warehouses across Ontario. It purchases and receives into its warehouses all beer, wine and spirits imported from other provinces and countries, as well as some domestic wine and beer and all domestic spirits. It then ships products by private carrier to LCBO stores across the province. The LCBO wholesales imported beer to the BRI for resale and ships it by private carrier to BRI warehouses and stores around Ontario.

BRI has seven regional depots. It purchases and receives domestic beer into these depots and ships these products with its own truck fleet to BRI stores across the province. BRI also wholesales domestic beer to the LCBO for resale and ships the product in its own trucks to LCBO stores. In addition, some small domestic brewers deliver their products to LCBO retail stores.

Licensed establishments purchase spirits, wine and beer from LCBO retail stores and licensee depots. Agency stores purchase these products from the nearest LCBO retail store. Licensed establishments and agency stores also purchase beer from BRI. Duty-free stores purchase spirits, wine and beer from the LCBO and beer from domestic brewers.

Other Participants

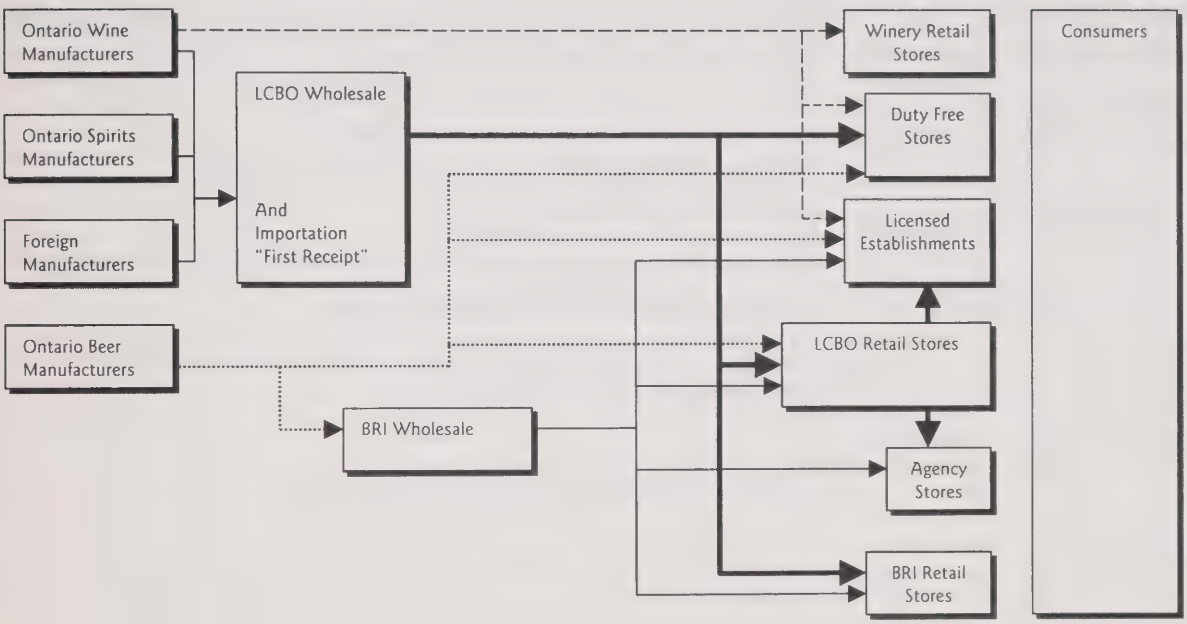
The beverage alcohol system also includes the following elements, tallied as of 2003–04:

- 17,095 bars, restaurants, hotels and other establishments licensed for sale and service of alcohol on premises,
- 340 liquor delivery services,
- 610 brew-on-premises facilities, and
- 557 manufacturers' representatives (who solicit and receive orders for sales transacted through the LCBO), including import agents.

In addition, Ontario has 14 duty-free stores licensed by the federal government and authorized by the LCBO.

FIGURE 4. FLOW OF GOODS

FIGURE 5. ONTARIO'S SYSTEM



APPENDIX D. ANALYTICAL PROCESS AND FRAMEWORK

The task of reviewing and developing recommendations on the beverage alcohol system in Ontario is a complex one. At the outset, the Panel concluded that a robust analytical approach would be required to inform its work and guide its conclusions. The aim was to ensure a comprehensive and objective review that fairly evaluated all options against the government's objectives, competitive market realities, initiatives in other jurisdictions and feasibility of implementation.

Analytical Approach Explained

Step 1. Identification of the Objectives and Priorities

We used the key principles established by the government to clearly define the objectives for our work:

- safeguard socially responsible storage, distribution and sale of beverage alcohol;
- convenience, variety and competitive prices for consumers;
- maximize value to Ontario taxpayers;
- ensure responsible reuse and recycling practices; and
- promote Ontario's products.

Step 2. Research and Consultation

We placed strong emphasis on comparisons with successful approaches in other jurisdictions. We assessed what is done elsewhere and why, the results achieved and the lessons learned.

Step 3. Delineating the Scope

We closely examined the specific business functions and activities underlying the beverage alcohol system. The goal was to better understand the discrete elements of business operations as the basis for a more meaningful analysis.

Each key business activity was probed at an appropriately detailed level to determine

- areas for potential operational improvement,
- overlaps, redundancies or synergies,
- costs,
- performance, and
- fit with key priorities and objectives (outlined above).

Step 4. Identifying the Options

We identified and investigated a broad, comprehensive range of possible options. The goal was to ensure that no viable option for organizing the system was overlooked. In investigating each option we considered

- operating models for wholesale and distribution, and retail,
- governance models for each option (such as existing corporate frameworks like a joint venture or a share capital corporation), and
- financing models for the operating and governance models.

Step 5. Preliminary Risk Analysis

We then weighed the risks flowing from each of the options. We sought to understand

- the risks linked to the current environment and industry model;
- the changing risk profile connected with moving to a new model;
- the implications of the current and changing risk profile in terms of mitigation strategies, probability of the risk occurring, and the impact of the risk (at this stage, all at a high level);
- the key mission-critical variables – i.e., those items that must be managed carefully or, if they cannot be mitigated, must be identified early and their impact assessed.

Step 6. Qualitative Assessment

Each of the options was viewed through a qualitative screen. We used our key objectives and priorities as the basis for a qualitative assessment to identify the options with the most potential to achieve the best balance of outcomes.

Step 7. Consolidation of Options

The subset of options was consolidated through a second process of qualitative assessment focusing on potential risks and the degree to which the options achieved mission critical objectives. Examples of mission critical objectives include the ability of the model to maintain or enhance government revenues and preserve social responsibility controls.

Step 8. Quantitative Analysis

We subjected the surviving – i.e., consolidated – options to a financial analysis. The options were ranked, and those that did not pass the necessary economic tests, such as revenue to government and financial attractiveness to market participants, were eliminated.

Step 9. Transition Considerations

We developed a high-level outline of the key elements of the transition plan to move from the current industry model to the short list of options. Transition issues we considered included costs, timing, labour and legal implications, regulation and enforcement.

Step 10. The Economic Model

As the concluding step, we constructed an economic model to provide the grounding for our final recommendation. The economic model integrates the operational, structural, financial and transitional characteristics noted above with other key elements, including governance (such as legislative, regulatory or contractual requirements) and payment mechanisms and pricing. At a high level, the model describes a complete map of our recommended path forward.

APPENDIX E. THE PANEL'S ADVISORS

The Panel engaged a range of consultants to provide specialized expertise. They included

- Centre for Addiction and Mental Health
- Dorey & Crossley Communications Ltd.
- Fasken Martineau DuMoulin LLP
- Grant Thornton LLP
- Karabus Management Inc.
- PricewaterhouseCoopers
- RBC Capital Markets
- Redbrick Communications

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